CONCLUSION

The petition should be denied.

[illegible]

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

ANDREW W. COMSTOCK, holder of Missouri Pacific Railroad Company 5¼% Secured Serial Gold Bonds, etc., *Petitioner*, *against* GROUP OF INSTITUTIONAL INVESTORS HOLDING FIRST AND REFUNDING MORTGAGE 5% GOLD BONDS, ETC., ET AL., *Respondents*.	No. 451

BRIEF

OF

THE GROUP OF INSTITUTIONAL INVESTORS HOLDING FIRST AND REFUNDING MORTGAGE BONDS OF MISSOURI PACIFIC RAILROAD COMPANY,

MANUFACTURERS TRUST COMPANY, AS CORPORATE TRUSTEE UNDER THE FIRST AND REFUNDING MORTGAGE OF MISSOURI PACIFIC RAILROAD COMPANY

AND

BONDHOLDERS PROTECTIVE COMMITTEE FOR MISSOURI PACIFIC RAILROAD COMPANY GENERAL MORTGAGE BONDS,

RESPONDENTS.

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Dated: February 28, 1948.

INDEX

Cases

PAGE

Other Authority

Statutes

* References too numerous for effective citation. Pertinent portions of subdivisions (d) and (e) of Section 77 are printed in Appendix I.

ABBREVIATIONS USED IN THIS BRIEF

Beaumont:	The Beaumont, Sour Lake Western Railway Company, a subsidiary of New Orleans and a debtor in these proceedings.
Brownsville:	The St. Louis, Brownsville & Mexico Railway Company, a subsidiary of New Orleans and a debtor in these proceedings.
CL:	Conclusion of Law.
Commission:	Interstate Commerce Commission.
Court below	Circuit Court of Appeals for the Eighth Circuit.
District Court:	United States District Court, Eastern Division, Eastern Judicial District of Missouri.
Ex.:	The two volumes of exhibits contained in the transcript of the record. Arabic numerals following this abbreviation refer to the page number.
FF:	Finding of fact.
First and Refunding Bonds:	Missouri Pacific Railroad Company First and Refunding Mortgage 5% Bonds.
GCL:	Gulf Coast Lines. Unless otherwise indicated, this term refers to New Orleans and its fourteen subsidiaries listed in Ex. 98. The term does not include the I-GN.
General Mortgage Bonds:	Missouri Pacific Railroad Company General Mortgage 4% Gold Bonds.
Group:	The Group of Institutional Investors holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company.
I-GN:	International-Great Northern Railroad Company, a subsidiary of New Orleans and a debtor in these proceedings.
Intercompany claim:	The claim of the Missouri Pacific against the New Orleans filed in the reorganization proceedings in the principal sum of $10,565,226.78 (FF. 18, R. 18; Ex. 1).

uri Pacific:	Missouri Pacific Railroad Company, the principal debtor in these reorganization proceedings.
Orleans:	New Orleans, Texas & Mexico Railway Company, a subsidiary of Missouri Pacific and a debtor in these proceedings.
	The transcript of the record, excluding the two volumes of exhibits and record volume IV. Arabic numerals following this abbreviation refer to the page number.
V:	The transcript of proceedings in the Circuit Court of Appeals and Opinion.
:	Railroad Credit Corporation.
:	Reconstruction Finance Corporation.
on 77:	Section 77 of the Bankruptcy Act (11 USCA §205).
ed Serial nds:	Missouri Pacific Railroad Company, 5¼% Secured Serial Gold Bonds.
Plan:	The Plan of Reorganization set forth in the Supplemental Order of the Commission dated April 9, 1940 [239 ICC 7]
Plan:	The Plan of Reorganization set forth in the Third Supplemental Order of the Commission dated October 9, 1944 [R. 20894-20968].

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

ANDREW W. COMSTOCK, holder of Missouri Pacific Railroad Company 5¼% Secured Serial Gold Bonds, etc., *Petitioner*, *against* GROUP OF INSTITUTIONAL INVESTORS HOLDING FIRST AND REFUNDING MORTGAGE 5% GOLD BONDS, etc., *et al.*, *Respondents.*	No. 451

BRIEF

OF

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AND

BONDHOLDERS PROTECTIVE COMMITTEE FOR MISSOURI PACIFIC RAILROAD COMPANY GENERAL MORTGAGE BONDS,

RESPONDENTS.

Opinions Below.

Circuit Court —*Comstock* v. *Group of Institutional Investors, et al.,* 163 F. 2d 350 (C.C.A. 8th, 1947). (R. IV, 13-27)

District Court—*In re Missouri Pacific R.R. Co.,* 64 F. Supp. 64 (E.D. Mo. 1945) (R. 1089)

Jurisdiction.

Petitioner invokes the jurisdiction of this Court under Section 240(a) of the Judicial Code, as amended. 28 USCA §347(a).

Preliminary Statement.

There are two matters which require consideration before taking up the facts.

Nature of the Proceedings.

These are proceedings for the reorganization under Section 77 of the Missouri Pacific, the New Orleans and affiliated railroad corporations. Pursuant to Section 77(d), the Commission certified a second plan of reorganization in October 1944. (R. 20892) Petitioner, Comstock, and others filed a number of objections to the 1944 Plan. Comstock's Objection 19 (R. 232, 237-247) asserted that the 1944 Plan was unfair and inequitable because, in the allocation of new securities to the Secured Serial Bonds, the Commission failed to treat the intercompany claim as invalid or subordinate to the New Orleans capital stock.[1] In January and March 1945, the district court held hearings [2] on objections to the 1944 Plan as required by Section 77(e). In accordance with the opinion of the district court (R. 1089) two orders were entered on January 22, 1946; one, No. 2604-A (R. 34), overruling Comstock's Objection 19, and the other, No. 2604-B (R. 1126), approving the 1944 Plan generally. The writ herein was granted

[1] Other Comstock objections, numbered 1-8, 13 and 26, are based in whole or in part upon his Objection 19. (R. 228-230, 231, 234)

[2] At the close of Petitioner's case the hearing on Objection 19 was separated from the hearing on other objections to the Plan. (R. 378, 714-723)

to review an order of the court below (R. IV, 28), entered on August 28, 1947, affirming Order No. 2604-A.[1]

Petitioner's brief treats the proceedings in the district court involving his Objection 19 as if they were hearings on objections to the intercompany claim. The Petitioner persisted in this attitude at the hearing despite the refusal of the district court to so narrowly limit the issues. (R. 386-390, 585, 694, 711-712, 714-735) Order No. 2604-A is based only in part upon a conclusion of law that the intercompany claim ought to be allowed. (CL. 8, R. 31) The district court in overruling Objection 19 determined a more comprehensive issue, namely, that, in so far as that objection is concerned, the 1944 Plan is fair and equitable. (CL. 18, R. 33-34)

At the request of the court below, the Commission filed a brief in the appeals from Order No. 2604-B approving the 1944 Plan generally, suggesting that, because of substantial changes in conditions, said Plan required further review by the Commission. On September 9, 1947—two years and eleven months after the Commission certified the 1944 Plan—the court below, pursuant to the suggestion of the Commission and with the approval of the appellants and appellees, entered an order vacating and setting aside Order No. 2604-B and directing that the district court return the 1944 Plan to the Commission for "further investigation, consideration and recommendation".[2] Further hearings on the plan before the Commission are scheduled to begin on March 23, 1948.

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[1] Writs were also granted to review three orders, entered in the court below on August 28, 1947, dismissing protective appeals which Petitioner had taken in the names of Mr. Thompson, as Trustee, and the New Orleans from Order No. 2604-A and an appeal from an Order of the district court denying permission to appeal from order No. 2604-A in the name of Mr. Thompson, as Trustee. (R. IV, 31, 33, 34)

[2] *Wright* v. *Group of Institutional Investors*, 163 F. 2d 1022 (C.C.A. 8th, 1947).

Petitioner's Improper Use of Matter Outside the Record.

The Petitioner stated in his reply brief in support of his application for certiorari that he accepted the findings of the courts below. (p. 2) His statement on this subject was:

> "We assume the findings of the District Court. Our challenge is directed only to the legal import of these unchallenged facts."

In his brief on the merits Petitioner utterly ignores this statement. His main brief is devoted largely to argument of the facts. Again and again throughout the brief this Court is asked to go through the record and to find the facts in accordance with Petitioner's version.

Petitioner is not satisfied with the record upon which the findings are based. To support his conclusions as to the facts, he relies on a miscellaneous collection of documents not in the record, which include a Senate committee report, a transcript of hearings before a Senate subcommittee and a report of the Commission to Congress. If these extraneous documents are to be included, this Court will have before it what is in effect a new record which neither of the courts below considered in connection with the findings. Petitioner in reality is asking for a new trial in this Court upon a new record.

The documents *dehors* the record are cited on the mere pretext that this Court will take judicial notice of them. Whether or not this Court will take judicial notice of these documents is irrelevant. They are cited to establish the truth of the facts therein recited or to discredit one of the witnesses. Petitioner offered some of these documents at the hearing before the Commission on the 1944 Plan. The trial officer properly excluded them. (R. 160-161) Petitioner made no effort to have these documents admit-

ted in evidence at the trial although an unsuccessful attempt was made to use them for the purpose of impeaching a witness. (R. 962-968) Because of the obvious impropriety of citation to documents outside the record, we will ignore them.

It seems to us that the Petitioner has not fulfilled the statements made to this Court as to the nature of the issues to be presented on this review. This Court presumably granted the writ for the purpose of considering certain questions of law. Instead, Petitioner is asking for a new trial. For the reason stated in Point I of this brief, the Petitioner is not entitled to a new trial. Accordingly, the writ should be dismissed without examining the merits of the Petitioner's contentions.

The Facts.

The Petitioner's brief is largely predicated upon the theory that the facts of this case call for application of the principles of the *Deep Rock*[1] case. His statement of the facts is an effort to fit them into the mold of that decision. The result is a one-sided statement containing errors and omissions. As already noted, the findings are to a large extent ignored. Consequently, we find it necessary to restate the facts and to integrate our statement with the findings.

Petitioner charges that the Missouri Pacific management dominated and controlled the New Orleans, caused it to pay illegal and improper dividends, made improper loans to it, imposed unfair transactions upon it, and generally mismanaged it. In order to understand the matters of which Petitioner complains, it is necessary to examine the setting in which they occurred. An improvement program or any

[1] *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (1939).

other single feature of railroad operations cannot be considered separately in abstract. A dividend policy or the propriety of borrowing cannot be judged on the basis of the books of account alone as the Petitioner has tried to do in his brief. This is particularly true in considering issues of the kind presented by the record now under review. These issues involve an attempt to determine, after the lapse of many years, the motives and purposes of the men who constituted the Missouri Pacific management. Many of these men were dead at the time of the trial. In passing judgment on the Missouri Pacific management during the years 1925-1932, it is necessary to understand some of the basic facts relating to the railroad system they were operating and what they were trying to accomplish. One of the most important and far-reaching developments in the history of the Missouri Pacific System since 1917, and one which is a clear indication of the purposes of that management, was the adoption of the Baldwin Improvement Program.

The Baldwin Improvement Program 1923-1930.

The late Mr. L. W. Baldwin came to the Missouri Pacific as president in 1923. He saw that large sums of money would have to be spent to make it a first class railroad system, and it was decided by the management to put Mr. Baldwin in a position to make the Missouri Pacific such a railroad. The improvement and expansion program, inaugurated in 1923, came to an end in 1930. Over $200,000,000 was spent in carrying it out. The program included acquisition of the GCL, which controlled the I-GN, and a fifty per cent. interest in the Denver & Rio Grande Western. These were considered necessary for the strategic development of the system. The results of

this program were notable. At the beginning of the period Missouri Pacific's share of southwestern business was approximately 22%. At the close of this period this had increased to 27%, a shift which Mr. Wyer[1] described as revolutionary. (R. 880-882) Group Exhibit 25 (column 12) shows what was done in this period. (Ex. 269, R. 883-885) From 1917 to 1922 average annual expenditures for additions and betterments were $7,118,000. During the Baldwin Improvement Program they averaged $23,785,000 per annum. In 1931-1939 they averaged $5,988,000, and for the War period, 1940-1943, the average was $10,293,000. In the whole history of the Missouri Pacific since 1917 there is nothing at all comparable to the Baldwin Improvement Program. (R. 884; FF. 5, R. 10)

Acquisition of the GCL-1924.

In 1924 the Missouri Pacific purchased the controlling capital stock interest in the New Orleans. This purchase was financed in part by an issue of fifteen-year sinking fund notes of the Missouri Pacific. The unpaid portion of these 7% notes was refunded in 1926 by the sale of the Secured Serial Bonds in the principal amount of $13,156,000. (R. 630-631) These bonds were secured by the pledge of $1,000 par value of New Orleans capital stock for each $1,000 principal amount of outstanding bonds. (Ex. 146, 177; R. 611, 630; FF. 6, 7, R. 11)

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[1] Mr. William Wyer was called as an expert witness by the Group. He had been Secretary and Treasurer of the Missouri Pacific and the New Orleans. At the time Mr. Wyer testified he was Chief Executive Officer of the Central Railroad of New Jersey. Mr. Wyer is a member of a firm of railroad consultants who have been retained in a number of railroad reorganizations, including the Wabash, Alton, Chicago & Northwestern, Denver, Rio Grande & Western, Erie, New Haven, Seaboard, Central of Georgia, and the Florida East Coast. (R. 868-870)

Description of the GCL.

The fifteen companies in the GCL system operate approximately 1,736 miles of railroad, the principal lines of which extend from the lower Rio Grande Valley in Texas around the Gulf Coast to Anchorage and New Orleans, Louisiana. (Ex. 267, R. 870; Ex. 268, R. 873; FF. 8, R. 12)

The Missouri Pacific System map opposite this page [1] shows that the railroad of the GCL connects with the Missouri Pacific at Kinder, Louisiana. This connection provides the shortest route from points along the Gulf Coast Lines to St. Louis, Chicago and the east. *Control of Gulf Coast Lines by Missouri Pacfic R. R.*, 94 ICC 191, 199 (1924). Another connection with the Missouri Pacific is made via the lines of the I-GN from Houston to Longview, Texas, and the lines of the Texas & Pacific, a Missouri Pacific subsidiary, from Longview to Texarkana. These afford a route to Kansas City, Omaha and points to the north and west.

The New Orleans itself operates only about 11% of the total GCL mileage. (R. 874; FF. 8, R. 13) It is primarily a holding company owning all of the stock and bonds of the other fourteen companies. (R. 874; FF. 3, R. 9-10) It is the only one of the GCL group which had any securities outstanding in the hands of the public.[2] The railroad of the Brownsville extending from Houston to Brownsville, Texas, is the most important of the group.

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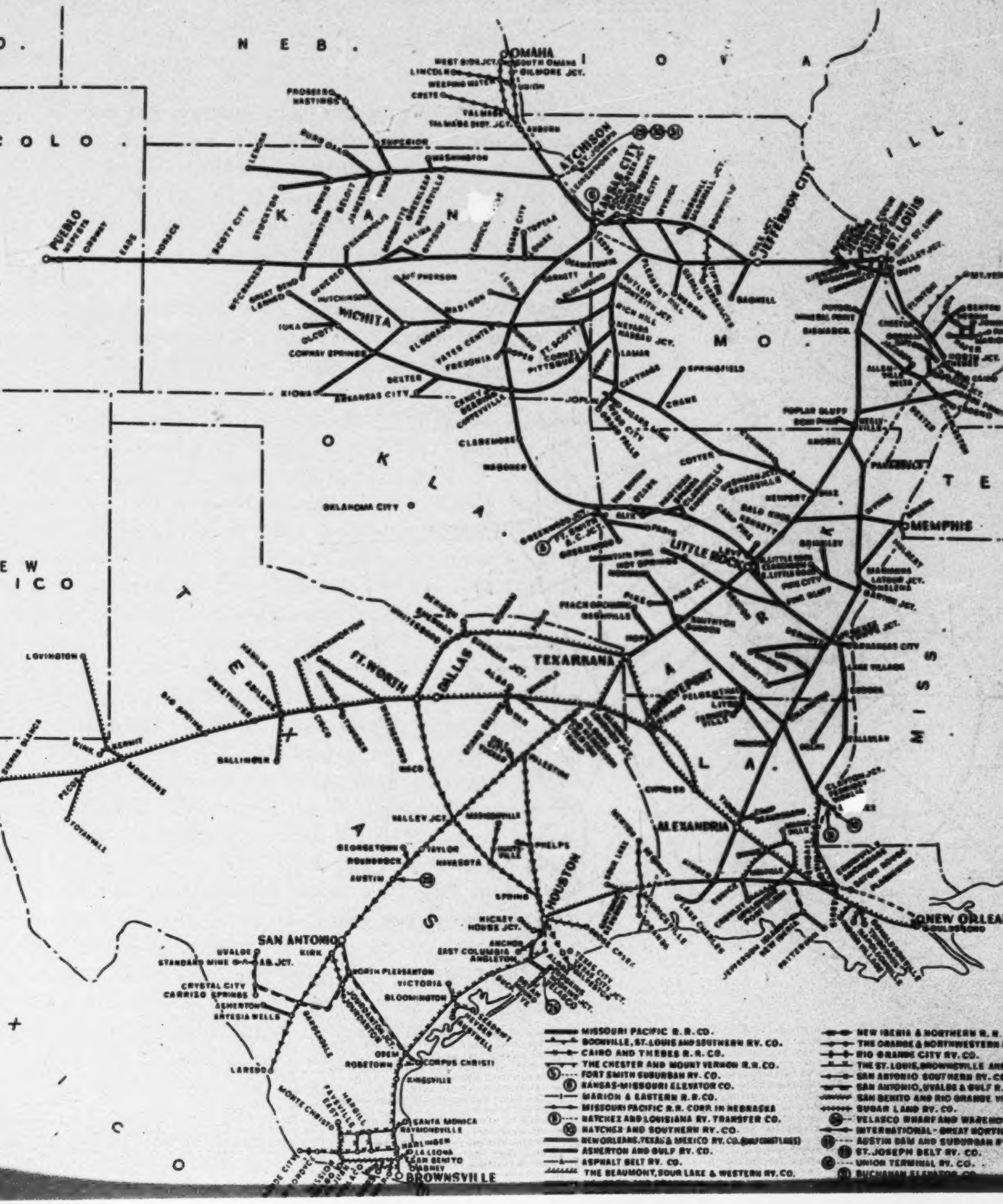
[1] This is a copy of Exhibit No. 7 admitted in evidence at the Commission hearing on the 1940 Plan. Group Exhibit No. 23 (Ex. 267, R. 870) is an enlarged reproduction of part of Exhibit No. 7 which, inadvertently, was referred to by Mr. Wyer as "Exhibit No. 1". (R. 870)

[2] During the period 1925-1932 the Brownsville had a small amount of equipment obligations outstanding in the hands of the public. Current indebtedness to general creditors of the GCL subsidiaries during this period was also small. (FF. 3, R. 9-10)

MAP OF MISSOURI PACIFIC SYSTEM



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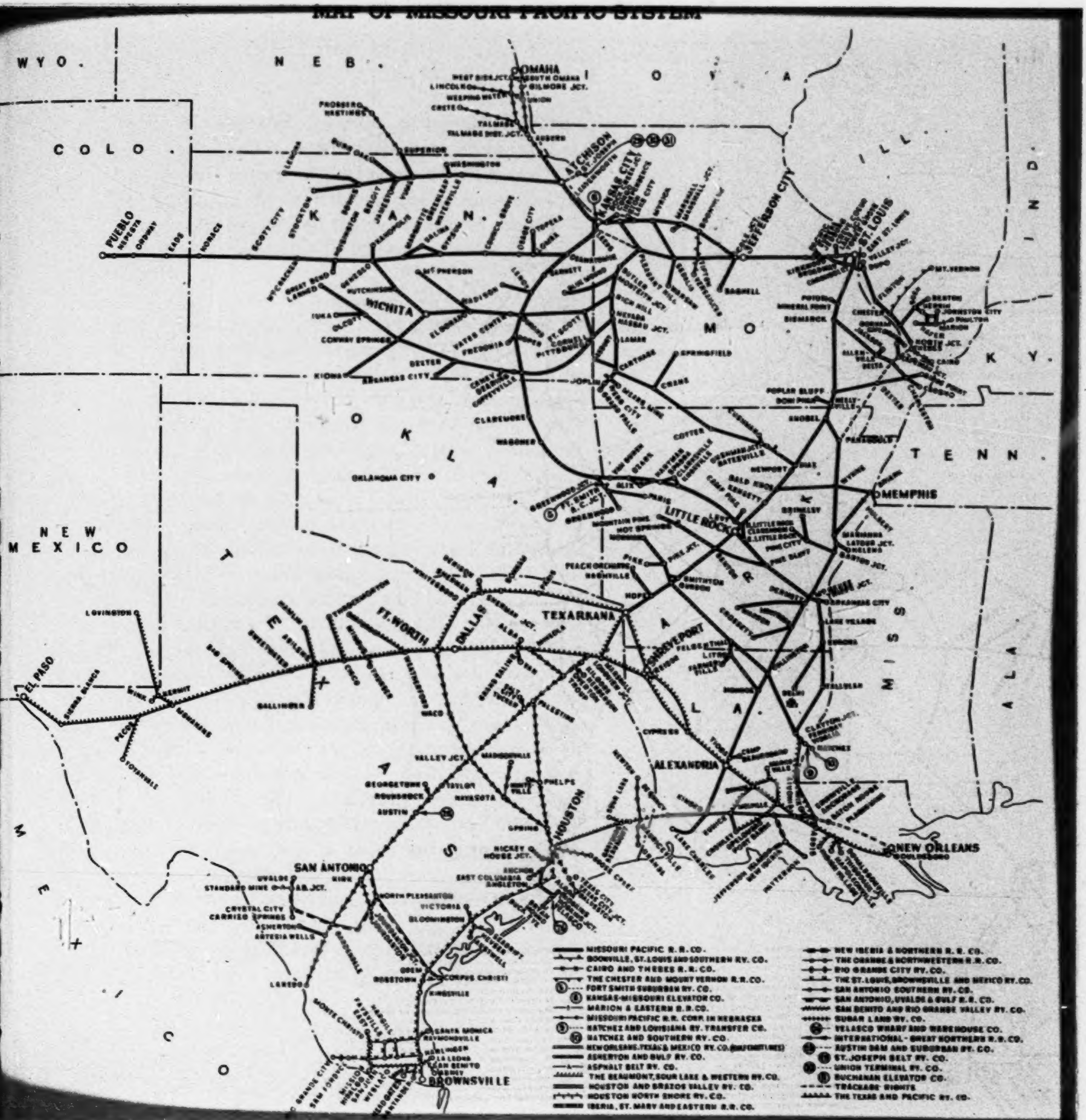
MAP OF MISSOURI PACIFIC SYSTEM
WYO.
NEB.
IOWA
COLO.
KAN.
MO.
ILL.
IND.
KY.
TENN.
OKLA.
ARK.
MISS.
ALA.
LA.
TEXAS
NEW MEXICO
MEXICO
OMAHA
ATCHISON
KANSAS CITY
JEFFERSON CITY
ST. LOUIS
PUEBLO
WICHITA
SPRINGFIELD
JOPLIN
OKLAHOMA CITY
MEMPHIS
LITTLE ROCK
TEXARKANA
SHREVEPORT
ALEXANDRIA
NEW ORLEANS
DALLAS
FT. WORTH
EL PASO
HOUSTON
SAN ANTONIO
AUSTIN
CORPUS CHRISTI
LAREDO
BROWNSVILLE
MISSOURI PACIFIC R. R. CO.
BOONVILLE, ST. LOUIS AND SOUTHERN RY. CO.
CAIRO AND THEBES R. R. CO.
THE CHESTER AND MOUNT VERNON R. R. CO.
FORT SMITH SUBURBAN RY. CO.
KANSAS-MISSOURI ELEVATOR CO.
MARION & EASTERN R. R. CO.
MISSOURI PACIFIC R. R. CORP. IN NEBRASKA
NATCHEZ AND LOUISIANA RY. TRANSFER CO.
NATCHEZ AND SOUTHERN RY. CO.
NEW ORLEANS, TEXAS & MEXICO RY. CO.
ASHERTON AND GULF RY. CO.
ASPHALT BELT RY. CO.
THE BEAUMONT, SOUR LAKE & WESTERN RY. CO.
HOUSTON AND BRAZOS VALLEY RY. CO.
HOUSTON NORTH SHORE RY. CO.
IBERIA, ST. MARY AND EASTERN R. R. CO.
NEW IBERIA & NORTHERN R. R. CO.
THE ORANGE & NORTHWESTERN R. R. CO.
RIO GRANDE CITY RY. CO.
THE ST. LOUIS, BROWNSVILLE AND MEXICO RY. CO.
SAN ANTONIO SOUTHERN RY. CO.
SAN ANTONIO, UVALDE & GULF R. R. CO.
SAN BENITO AND RIO GRANDE VALLEY RY. CO.
SUGAR LAND RY. CO.
VELASCO WHARF AND WAREHOUSE CO.
INTERNATIONAL - GREAT NORTHERN R. R. CO.
AUSTIN DAM AND SUBURBAN RY. CO.
ST. JOSEPH BELT RY. CO.
UNION TERMINAL RY. CO.
BUCHANAN ELEVATOR CO.
TRACKAGE RIGHTS
THE TEXAS AND PACIFIC RY. CO.

The Brownsville operates one-third of the GCL mileage and, during the period with which we are concerned, contributed from 61% to 84% of the income of the group. (R. 927; FF. 8, R. 12) It is not surprising, therefore, to find that the greater part of the New Orleans income is derived from its investments in the securities of the GCL subsidiaries.

Seven of the fourteen GCL subsidiaries were not a part of the GCL system in 1924, these having been acquired by the New Orleans during the period 1925-1931. (Ex. 98, R. 488; FF. 3, R. 9-10) Although not urged in his petition for certiorari Petitioner charges that five of these seven GCL subsidiaries were acquired by the New Orleans for the benefit of the Missouri Pacific System. These five subsidiaries are referred to as "North Texas Feeder Lines", although none of them is located in north Texas, as the map opposite page 8 will show. It is stated that the acquisition of the five short lines by the New Orleans resulted in injury to it and benefit to the Missouri Pacific and the I-GN. (Petitioner's brief, pp. 18 and 19) It is also asserted that "some" of these short lines do not even connect with the Gulf Coast Lines. Two of them have no direct connection with the Gulf Coast Lines. One, the Asherton & Gulf, is a 32-mile branch line extending to the north of the I-GN route between Gardendale, Texas and the Mexican border. The other, the Sugar Land, owns a 19-mile branch line connecting with the I-GN near Houston, Texas. (Ex. 268, R. 873) Petitioner offered no proof at the trial to show in what directions traffic from these five short lines flows. Nor is there any proof showing the proportion of traffic originating on these short lines delivered to the Gulf Coast Lines. Nor is there any proof showing that the GCL traffic originating and terminating on these lines is profitable or unprofitable. Petitioner, instead, builds a whole structure of assumptions upon Mr.

Baldwin's statement that some of the short lines "tie in" with the I-GN. (R. 605-606) It might just as well be assumed, for example, that the Asherton & Gulf runs to a rock quarry which is a source of supply for GCL ballast.

The I-GN itself was a subsidiary of the New Orleans. This had been true since prior to the Missouri Pacific's acquisition of the New Orleans. It is immaterial that, from an operational standpoint, Mr. Baldwin looked upon the I-GN as a Missouri Pacific subsidiary. (R. 603-604)

The comments of the Commission, only partly quoted at pages 18 and 19 of Petitioner's brief, suggest no impropriety in the acquisition by the New Orleans of the short lines. (239 ICC at 71) As Mr. Wyer testified, branch lines frequently operate at a deficit. Their value is in the traffic contributed to the main line. (R. 873)

It was proposed by way of compromise in the plans discussed by the Commission that the deficits of the short lines be allocated over the system in accordance with the benefits derived from traffic obtained from the short lines. These and other adjustments formed the basis for allocation of new securities to the New Orleans security holders. After considering these matters, the Commission certified its 1940 Plan and thereafter its 1944 Plan. Thus, the 1944 Plan now under review has already given effect to any adjustments which need to be made. Nevertheless Petitioner seeks to obtain a further advantage, by way of subordination, on the basis of these same facts.

This matter of the short lines serves to emphasize the importance of what is said in Point VI of this brief. (p. 76, *infra*) Matters such as this were gone into in great detail at the first hearings before the Commission on the 1940 Plan. At that time it would have been appropriate for Petitioner to have raised his subordination issue. Matters such as these are within the field of the Commission's expert knowledge. Its findings would have been an essential prerequisite to a consideration of these

matters by the district court. Yet Petitioner asks this Court to try these issues upon the incomplete facts in the record.

The Petitioner was required by the order setting the date for the 77(e) hearing on the 1944 Plan and by the provisions of Section 77(e), to specify in detail his objections to the 1944 Plan.[1] No mention of the short lines is made in his objections and, aside from a few questions addressed to Mr. Baldwin at the district court hearing, the Petitioner gave no indication that he had any objection pertaining to acquisition of the five short lines. (R. 243-244, 605-606) These omissions are inexcusable. The transcript of the proceedings before the Commission on the 1940 Plan was available to Petitioner and so was the Commission's 1940 Report from which he quotes. Moreover, his witness Delaney spent a month in the St. Louis and Houston offices of the debtors going over their books. (R. 477, 495) The first statement of his objections concerning any of the short lines appeared in the Petitioner's district court brief after the record had been closed. The proponents of the plan were at least entitled to know the issues which they were required to meet. In this state of the record the district court was bound to find against the Petitioner. (FF. 3, 4, R. 9, 10)

Comparison of the GCL before and after Missouri Pacific Acquisition.

In making his charges of mismanagement and overreaching, Petitioner completely ignores facts which show

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[1] "§77(e). Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment."

a scrupulous regard for the separate rights of the New Orleans and its security holders. He also brushes aside the great improvement in physical condition and traffic which occurred in the GCL during the Missouri Pacific regime. In dealing with this aspect of the case, we will consider, first, physical condition, and, second, traffic, in each case making comparisons between the period when the GCL was under independent management and the period after the Missouri Pacific acquired control.

(1) *Physical Condition.*

At the time arrangements were made for acquisition of the controlling interest in the capital stock of the New Orleans in the spring of 1924, it was apparent that substantial improvements would be necessary in order to make the GCL a first class railroad system. These properties had emerged in 1920 from Federal control in an unsatisfactory condition. They had been undermaintained (R. 829-830) and the condition of track and roadbed was such that the high-speed trains, which were put into operation in later years for the handling of perishable traffic from the Valley, could not have been operated. (R. 831) There was much old and obsolete equipment. The exhibits of Messrs. Rodgers[1] and Kirkpatrick[1] give a fair indication of the condition of the GCL road and equipment at the time the Missouri Pacific acquired control of the New Orleans. (Ex. 249, 251-253, R. 815, 829; see also R. 814-815, 819-823, 828, 832, 834; FF. 9, R. 13)

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[1] Mr. D. Rucker Rodgers, of the Mechanical Department, was called as a witness by the Group. He had had approximately 42 years of railroad experience. (R. 814) Mr. C. S. Kirkpatrick, Chief Engineer of the GCL since 1916 and of the I-GN since 1925, was called as a witness by the Group. He had been engaged in railroad location, construction and maintenance work since 1900. (R. 827-828)

At the end of 1923 only 16.6% of GCL ties were creosoted. This compares with 87.7% at the end of 1931. (Ex. 251-253, R. 829) New rail laid in the period prior to 1924 averaged 3,594 tons per annum. This compares with an average of 5,760 tons per annum for the period after 1924. (Ex. 251-253, R. 829)

If a similar comparison is made of the equipment data for the two periods, the result is likewise favorable to the second period. (Ex. 249, R. 815) Locomotive failures averaged 21,000 miles per failure in the earlier period, 111,000 miles in the second period and 302,000 and 204,000 miles, respectively, in the last two years of the second period. (Ex. 249, R. 815) Testing the condition of locomotives on the basis of inspection by the Commission's inspectors, the second period likewise shows very great improvement. The data shown on Group Exhibit 16 (Ex. 249, R. 815) with respect to freight cars and passenger cars indicates that the condition of this equipment was substantially better in the second period than in the first. (R. 821, 822)

The effect of the Baldwin Improvement Program upon the GCL after its acquisition by the Missouri Pacific in 1924 is also notable. Group Exhibit 37 (Ex. 297, R. 910) shows what was done in the way of improvement on the GCL during the period of the Baldwin Improvement Program. It also furnishes a basis for comparison with the previous period beginning in 1916 when the GCL was under independent management. Of the $32,000,000 expended by the GCL for additions and betterments during the fifteen-year period 1916-1931, about $22,000,000, or nearly 70%, was expended during the six years 1925-1930. (R. 911) Mr. Kirkpatrick's exhibit (Ex. 255, R. 832) briefly describes the major additions and betterments to road and equipment during the period 1925-1932. The record convincingly demonstrates the very substantial improvement in the physical condition of the GCL which occurred after

the Missouri Pacific acquired a controlling interest in the New Orleans. (FF. 9, R. 13)

This improved physical condition had an important effect upon GCL traffic.

(2) *Traffic.*

Mr. J. A. Brown, the General Freight Agent and Freight Traffic Manager of the GCL from 1912 until 1927 and Chief Traffic Officer of the Missouri Pacific at the time of his retirement in June 1944, was called as a witness by the Group. (R. 840-841) He described some of the difficulties which the GCL encountered in dealing with other carriers prior to 1924. (R. 844-848) The lower Rio Grande Valley is an important citrus and vegetable producing region. (R. 842-843) Beginning in 1912 the GCL made various arrangements with connecting carriers for the handling of the perishable traffic beyond its lines. (R. 843-848) Prior to 1921 none of these arrangements was satisfactory. Either the division allowed to the GCL was too low or there was an inability to obtain the necessary supply of refrigerator cars to handle the perishable traffic. (R. 843-848) The above cited portions of the record clearly demonstrate that prior to 1924 the GCL was not in a strong position to bargain with other carriers. (FF. 10, R. 13-14)

For a number of years Mr. Brown had endeavored to make arrangements with the Illinois Central for the handling of the perishable traffic northward from Baton Rouge. In 1921 such an arrangement was consummated. It was considered by the independent management of the GCL as entirely satisfactory. (R. 848) It should be noted here that the running time for trains handling the perishable traffic between the Valley and St. Louis was 102 hours in 1924. (R. 850) The Baton Rouge route involved ferrying the trains across the Mississippi at Anchorage,

Louisiana. The average train required three river crossings which consumed six hours. (R. 850-851) After this traffic began to move via Kinder and the Missouri Pacific, these schedules were reduced as follows:

January 1, 1925....97 hours
October 21, 1927....72 hours
October 30, 1929....64½ hours
October 22, 1932....61½ hours (FF. 10, R. 14; R. 858).

In 1927 the Southern Pacific extended its line to the lower Rio Grande Valley and obtained initially about 20% of the perishable traffic moving out of the Valley by railroad. The GCL was able to hold the Southern Pacific to this ratio thereafter. Mr. Brown stated that without the aid of the Missouri Pacific the GCL could not have maintained its position against this competition. (R. 861-862; FF. 11, R. 15)

After 1927 a considerable amount of the perishable traffic began to move to Kansas City and beyond. The Southern Pacific and its connections have a shorter route to Kansas City than the Missouri Pacific System lines. The Missouri Pacific and its affiliate, the Texas & Pacific, together with the New Orleans and its subsidiary, the I-GN, established schedules from Houston to Kansas City which enabled the GCL to hold its position with respect to this traffic. Mr. Brown stated that this could not have been done without the aid of the Missouri Pacific. (R. 851-853; FF. 12, R. 15)

As noted, after acquisition of the GCL by the Missouri Pacific the perishable traffic moving to St. Louis and the east was delivered to the Missouri Pacific at Kinder. Mr. Brown testified as to the manner in which the divisions of the revenue from this traffic were made up. (R. 851-853)

The vegetable traffic will serve as an example. When this traffic moved via Baton Rouge the GCL received about 74% of the revenue. After it started moving through Kinder, Mr. Baldwin requested Mr. Perkins of the Missouri Pacific and Mr. Brown of the GCL to work out new divisions. He instructed them to make sure that the arrangements would be "liberal in favor of the GCL". (R. 853-855; FF. 13, R. 15) The negotiations between Mr. Brown and Mr. Perkins resulted in a division that gave to the GCL an advantage of about $5 per car over the arrangement which had theretofore existed between the GCL and the Illinois Central. (R. 854-855; FF. 13, R. 15) A few years later the advantage to the GCL in using the Kinder route as compared with the Baton Rouge route was even more marked as the result of the decision of the Commission in the *Southwestern Rate Divisions* case. After that decision, the advantage to the GCL on citrus amounted to $32 per car and on vegetables $27.82 per car. (R. 855-856; FF. 13, R. 16)

Another instance of the benefit to the GCL of its relationship with the Missouri Pacific is the arrangement which the GCL made with the American Refrigerator Transit Company for the supply of refrigerator cars. This Company is owned by the Missouri Pacific and the Wabash. In the handling of the perishable business it was important that the GCL have an adequate supply of refrigerator cars. The perishable traffic is seasonal, beginning in September and continuing through the spring months. (R. 844-845) It would have been too costly and quite impracticable for the GCL to have maintained its own supply of refrigerator cars. During the period prior to 1924 the GCL experienced serious refrigerator car shortages. (R. 844-845, 847-848) After 1924 no such difficulties were experienced. (R. 861) Thus, the GCL was greatly benefited and substantial sav-

ings were effected by having an adequate supply of refrigerator cars available to meet this seasonal demand. In addition to this, the American Refrigerator Transit Company made a special arrangement with the GCL whereby the refrigeration charge to the shipper accrued to the GCL, the latter being obligated to pay the actual costs of icing the refrigerator cars. This resulted in a profit to the GCL during the period 1924-1932 of $6,171,876. (R. 860; FF. 14, R. 16)

Thus far we have dealt with the perishable traffic moving out of the Valley. Group Exhibits 21 and 22 (Ex. 265, 266, R. 856, 861) deal with GCL traffic generally. The first of these exhibits compares the interchange at Kinder with the interchange at Baton Rouge for the years 1922-1931. It will be noted that, although Missouri Pacific deliveries to the GCL at Kinder increased substantially in the 1925-1931 period, the GCL continued to receive from the Illinois Central at Baton Rouge the greater portion of the traffic which it had theretofore received. This indicates that the diversion of the perishable traffic to the Missouri Pacific at Kinder did not have any serious results on the traffic received from the Illinois Central at Baton Rouge. The net effect was greatly to the advantage of the GCL. Group Exhibit 22 (Ex. 266, R. 861) compares for the years 1922-1931 total carloadings for all United States Class I railroads with total carloads received by the GCL from (1) all roads, (2) the Missouri Pacific and the I-GN, and (3) all roads other than the Missouri Pacific and the I-GN. It is significant that in every one of the years after 1924 the GCL was in a relatively better position from a traffic standpoint than the railroads of the United States generally. It should also be noted that, although the GCL received somewhat less traffic from non-System lines after 1924, this was more than made up by the receipts from

the Missouri Pacific and the I-GN. Group Exhibits 21 and 22 (Ex. 265, 266, R. 856, 861) demonstrate that from a traffic standpoint the GCL's relationship with the Missouri Pacific was of great benefit to the GCL. (FF. 15, R. 16)

We have dealt with some of the direct traffic benefits which the GCL derived from its relationship with the Missouri Pacific. There were also indirect benefits which are difficult to measure in dollars and cents. The Missouri Pacific widely advertised the products of the Rio Grande Valley. In addition to newspaper and magazine advertising, a special car was sent throughout the United States for the purpose of exhibiting the products of the Valley. (R. 859) The Missouri Pacific also maintained experimental farms in the Valley for the purpose of aiding the growers in improving the quantity and quality of their products. (R. 858) The purpose of these activities was, of course, to secure additional traffic for the System. (FF. 16, R. 17)

These improvements in roadbed, equipment and service were not only of benefit to security holders but also to the communities which the GCL served. As an example, the products of the lower Rio Grande Valley are in competition with perishable products from other sections of the United States. This competition was importantly affected by the length of time required for the movement of the perishables from the Valley to market. It seems obvious that the competitive position of the Valley producers was greatly improved as a result of the steps taken by the Missouri Pacific management to shorten train schedules and to see that an adequate supply of refrigerator cars was maintained. Thus did the Missouri Pacific contribute to the building up of the Gulf Coast territory and the creation of greater traffic for the GCL.

These are considerations which must be taken into account in passing judgment on the Missouri Pacific management. What we have shown is entirely inconsistent with the Petitioner's charges of mismanagement and overreaching. If there had been any disposition on the part of the Missouri Pacific management to take advantage of the GCL, they could have accomplished it most easily in their dealings with the GCL in respect of maintenance and traffic matters. It would have been quite simple to continue maintenance at substantially the levels which prevailed prior to the acquisition of the GCL. Also, in the matter of divisions the Missouri Pacific management could have taken advantage of the GCL if they had had the motives attributed to them in the Petitioner's brief. By such means the Missouri Pacific could have improved its earnings quite as effectively as by the declaration of the New Orleans dividends. Instead we find that the Missouri Pacific management leaned over backward in their dealings with the GCL.

Method of Financing Improvements.

As already noted, the Missouri Pacific spent over $200,000,000 on the Baldwin Improvement Program. (p. 6, *supra*) Such a program had to be financed. From 1917 to 1928 the Missouri Pacific put back into its improvement program approximately $49,000,000 available for dividends. (R. 887)

The remainder of the improvement program had to be financed through borrowing. It was not feasible to issue a few bonds each time that more funds were needed. Instead short term borrowings to finance the improvement program were allowed to accumulate to a point where they could be refunded by a bond issue large enough to be saleable. (R. 887) Group Exhibits 26, 27 and 28 illustrate the policy

which was followed on the Missouri Pacific. (Ex. 271, 273, 275, R. 888; R. 887-890; FF. 17, R. 17)

The same pattern was followed by the GCL. Group Exhibit 29 shows a typical GCL financing cycle which ended in February 1928. (Ex. 277, R. 890) During that cycle \$6,683,739 was spent by the GCL for additions and betterments. From time to time, as funds were needed for additions and betterments, the GCL obtained them by means of short term borrowings. After the short term borrowings had accumulated to approximately \$4,500,000, an issue of first mortgage bonds was sold to underwriters and the short term loans were refunded. (R. 887, 893-896; Ex. 277, R. 890) The new cycle which began in 1928 was interrupted by the depression. The advances which the Missouri Pacific had made to the New Orleans in this new cycle could not be refunded due to the fact that market conditions in 1931 rendered it impossible to sell long term obligations. (R. 896, 1022-1026; FF. 17, R. 17)

Advances by the Missouri Pacific to the GCL.

Following the refunding of the short term borrowings in 1928, the Missouri Pacific continued to make advances to the New Orleans. The net principal sum of these advances as of the date of bankruptcy amounted to \$10,565,227. (Ex. 239, R. 791) These advances fall into two categories, (1) those made during the period when dividends were being paid on the capital stock of the New Orleans, and (2) those made after that time and prior to bankruptcy. (R. 900-901; FF. 18, R. 18) The last dividend was declared on October 13, 1931. (Ex. 173, R. 617)

Petitioner asserts that approximately \$2,795,000 of the intercompany claim is made up of advances for dividends.

(Petitioner's Brief, p. 10, 11) This assertion, upon any theory of the facts, is incorrect.[1] Petitioner ignores the basic considerations which controlled the making of the advances. Mr. Wyer, who participated in the proceedings of the directors throughout almost the entire period of the new financing cycle which began in 1928 (R. 892, 893, 896, 918), gave a very clear statement of the basic policy which was followed by the Missouri Pacific in making the advances. (R. 887-910) He testified that until near the end of 1931 the advances were geared to the GCL capital expenditures. The Missouri Pacific directors were kept advised in detail as to the progress of additions and betterments, and Mr. Wyer left no doubt that the basic purpose of the advances was to enable the GCL to proceed with its improvement program. (Ex. 281, 297, R. 900, 910)

There is another consideration bearing on the purposes and propriety of these advances. The Missouri Pacific and the GCL were railroad corporations subject to the jurisdiction of the Interstate Commerce Commission. In December 1932, the Missouri Pacific applied to the Commission for authority to borrow from the RFC and to pledge to the RFC, among other collateral, $9,955,226.78 of the intercompany claim and advances of $2,486,000 made by the Mis-

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[1] The total of $2,795,000 at the foot of column 1 in the table on page 10 of the Petitioner's brief erroneously includes (1) advances of $300,000 and $250,000 made on November 30, 1928 and February 28, 1929, which were repaid on June 4, 1930, December 28, 1931 and February 27, 1932 (Ex. 239, R. 791) and (2) the full amount of six advances which were in excess of the so-called "matching" quarterly dividends of $259,576 each. (Ex. 301, R. 914) If these errors be corrected, the aggregate of all of the advances contained in the intercompany claim which could have been used for "matching" dividends is $2,082,456. Furthermore, this computation takes no account of the fact that the Missouri Pacific received only a part of these dividends.

souri Pacific to the I-GN. (R. 119) With respect to this collateral the Commission made the following finding:

> "The advances aggregating approximately $12,441,000, upon which interest is being currently paid at the rate of 6% per annum, represent open account indebtedness to the applicant by two of its controlled companies accumulated over a period of five years. All of these advances were used to pay for additions and betterments to the properties, except that during the last two years certain of the advances to the New Orleans, Texas & Mexico Railway Company were made to overcome operating deficits. In the case of both of the controlled companies the obligations to repay the advances lie between their first mortgage bonds and their capital stock. In the case of the International-Great Northern Railroad Company they are senior as to the payment of interest on $17,000,000 of adjustment mortgage bonds, but junior to that bond issue as to security." (R. 117).

The Commission authorized a further loan from the RFC to the Missouri Pacific and the pledge of collateral to secure the RFC loans which included $9,955,226.78 of the intercompany claim.

Section 20a(2) of the Interstate Commerce Act (49 USCA, §20(2)) provides:

> "It shall be unlawful for any carrier to issue * * * any * * * evidence of * * * indebtedness of the carrier * * *, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the commission of the purposes and uses of the proposed issue and proceeds thereof, * * *, the commission by order authorizes such issue * * *. The commission shall make such order only if it finds that such issue * * *: (a) is for some lawful object within its corporate purposes, and

compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose."

Subsection (9) of Section 20a excepts from the provisions of subsection (2) notes of a carrier maturing not more than two years after the date thereof and aggregating not more than 5% of the par value of the securities of the carrier then outstanding.

In February 1933, the New Orleans applied to the Commission under Section 20a for authority to issue $7,456,726.78 face amount of its notes to the Missouri Pacific. (R. 86) In its application the New Orleans showed that it was indebted to the Missouri Pacific for advances in the sum of $10,355,226.78, of which $400,000 was then represented by a promissory note, and that it had been requested by the Missouri Pacific to issue demand notes in the amount of $9,955,226.78 as evidence of the then remaining balance of indebtedness for advances. The application further recited that in partial compliance with that request the New Orleans had issued a demand note in the sum of $2,498,500, which together with the $400,000 note, exhausted its power to issue short term obligations under Section 20a(9) of the Transportation Act. The applicant sought authority to issue to the Missouri Pacific a promissory note bearing interest at the rate of 5½% per annum for the remainder of this indebtedness ($7,456,726.78). In complying with its statutory obligation, the Commission found:

> "* * * that the issue by the New Orleans, Texas & Mexico Railway Company of a note or notes in an aggregate amount not exceeding $7,456,726.78, as aforesaid, (a) is for a lawful object within its corporate purposes, and compatible with the public inter-

> est, which is necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose." *New Orleans, Texas & Mexico Railway Company Notes,* Finance Docket No. 9817; 189 ICC 600, 601 (1933) (R. 86, 20839-20840).

Petitioner's contention of borrowing to pay dividends is based entirely upon the near coincidence as to the dates of certain dividends and advances. This is quite superficial and ignores basic principles of accounting. It is not customary for any corporation, railroad or otherwise, to keep two separate cash accounts, one in which income is deposited and the other in which capital items are kept. Instead, cash income and proceeds of borrowing are mingled in a single cash account. This cash is drawn upon from time to time to meet cash requirements whether chargeable to capital or otherwise. However, the auditor, in applying the accounting rules to these receipts and disbursements, will treat separately the capital and income items. To illustrate, let it be assumed that the New Orleans receives $200,000 in cash on January 31st and that the cash represents net earnings. At the time of receipt of this cash the New Orleans needs $200,000 to pay a bill for a capital item such as a new freight yard. The officers know that on the succeeding April 1st they will need $100,000 in cash to pay a dividend. Instead of borrowing to pay for the new freight yard, the officers use the $200,000 of cash income to pay for it. Then, three days prior to the dividend date the officers borrow $100,000 to reimburse the treasury in part for the investment in the new freight yard. In handling the matter in this way the officers save the New Orleans about two months' interest on $100,000 of the money spent for the new freight yard. (R. 901-903)

The court below found that until near the end of 1931 the immediate purpose of the advances in question was to reimburse the New Orleans treasury for expenditures for additions and betterments and that the basic and underlying purpose of the advances during that period was to enable the GCL to make additions and betterments to its properties. (FF. 18, R. 18) These findings are amply supported by the evidence reviewed in the foregoing discussion of the advances. (Ex. 281, 297, R. 900, 910)

The advances made in the latter part of 1931 and thereafter were to cover operating expenses and interest and sinking fund requirements of the New Orleans first mortgage and equipment trust obligations. The net advances made during this period amounted to $3,148,683. Clearly these advances were of benefit to the Secured Serial bondholders. (FF. 18, R. 18, 19)

Petitioner's charges of mismanagement are based in part on the inclusion in the intercompany claim of an item of $1,261,009.84. (Petitioner's brief, pp. 16-18, 34-37) This item originally represented indebtedness due from the New Orleans and its subsidiaries to the I-GN, also a subsidiary of the New Orleans. With the exception of $211,218.90 of "interest on unpaid bills" owing by the GCL to the I-GN, the sum of $1,261,009.84 represented an advance of cash items such as fuel and supplies by the I-GN. (Ex. 221-225, R. 701, 697-705; R. 793-797, 1041, 1048) At the same time the I-GN was indebted to the Missouri Pacific in an amount in excess of $1,261,009.84. There was no sound reason why the I-GN should be carrying the New Orleans and its subsidiaries. (R. 797) The result of the transaction complained of was that the New Orleans became obligated to the Missouri Pacific in the sum of $1,261,009.84 and the Missouri Pacific cancelled a like amount of indebtedness owing by the I-GN to it. At the same time the obligations

of the New Orleans and its subsidiaries to the I-GN were cancelled. The transaction is evidenced by appropriate ledger entries on the books of each of the Companies affected.[1] (Ex. 221-225, R. 701 as corrected at R. 793-797; Ex. 240, R. 794; R. 1043, 1048-1049) It is asserted that this transaction "saddled" the New Orleans with uncollectible claims of the I-GN. The purported basis for this assertion is a reference to Mr. Eckert's testimony to the effect that the GCL could not pay the I-GN. (Petitioner's brief, p. 17) It is clear from his testimony on redirect that he had no intention of suggesting that the obligors were insolvent and could not ultimately pay their debts to the I-GN. (R. 1048-1049; see also R. 797, 1043; Ex. 240, R. 794) There is no basis in the record for the assertions in Petitioner's brief that the obligations of the GCL subsidiaries were uncollectible in whole or in any substantial part. This subject is dealt with at pages 28-30, *infra*. In any event the New Orleans had to protect its ownership and control of the GCL subsidiaries. The properties of the GCL subsidiaries constituted 89% of the GCL mileage. These bills for fuel and supplies were of direct benefit to the New Orleans and it could not have permitted them to remain unpaid.

The Petitioner has entirely overlooked the fiduciary obligation of the New Orleans to its subsidiary, the I-GN. If in fact some of these items owing to the I-GN were "uncollectible", it would have been a violation of New Orleans' fiduciary obligation to have "saddled" them on its subsidiary, the I-GN. Thus, if we assume Petitioner's

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[1] Petitioner, at page 34 of his brief, asserts that this transaction required approval of the boards of directors of the New Orleans and the I-GN. This point was not raised in the district court. For that reason and for the further reason that the cases cited on page 35 of his brief do not hold that board action was necessary, no further consideration will be given to the point.

version of the facts, he is complaining of a transaction which relieved the I-GN of a saddling operation.

In any event the transaction had not the slightest effect upon the GCL system. It owed $1,261,009.84 prior to the transaction and not a penny more thereafter. Clearly the holders and pledgees of the New Orleans capital stock were not prejudiced in the slightest by the transaction.[1] (FF. 28, R. 22)

Dividends Declared and Paid on the Capital Stock of the New Orleans.

Despite the findings of two courts to the contrary, Petitioner asserts that the New Orleans paid dividends out of capital. (FF. 31, R. 23-24, R. IV, 26) In considering this matter, which is largely factual, it is necessary to have an understanding of the method by which the accounts of the GCL subsidiaries of the New Orleans were handled.

(1) *Indebtedness of the GCL Subsidiaries to the New Orleans.*

Petitioner asserts that the income account of the New Orleans was improperly stated. His reasons for this assertion are that no reserve was established for past due obligations owing by the GCL subsidiaries to the New Orleans, and that some or all of the Brownsville dividends constituted mere "paper income". (Petitioner's brief, pp. 33-34, 13-14)

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[1] Petitioner's Objection 19 fails to mention the "saddling" transaction, although he was required by Section 77(e) to specify his objections in detail. (R. 232, 237, 247) The only suggestion of an objection at the trial was the emphasis put upon the fact that no cash changed hands. (R. 706, 792-795, 1041-1043, 1048) As noted in connection with the short lines matter (p. 11), *supra*), the proponents of the 1944 Plan were entitled to know the case they had to meet.

The past due indebtedness of various subsidiaries to the New Orleans largely consisted of advances made to these subsidiaries, interest on indebtedness and items which the witnesses referred to at the hearing as "family line bills". (R. 505-507) The family line bills were items owing by the GCL subsidiaries to the New Orleans for joint expenses, per diem, fuel, materials, supplies, etc. It is pointed out that this indebtedness to the New Orleans increased substantially over the period 1925-1932. (Petitioner's brief, footnote, p. 34) It is asserted that this indebtedness was not worth its face value for the reason that a large part of it was past due.

Mr. Wyer explained these items and the reason why they continued to accumulate. (R. 918-923) The New Orleans, although it operated only 11% of the GCL mileage, was banker for the entire GCL system. As noted at page 8, *supra,* it was the only one of the GCL companies which had any securities outstanding in the hands of the public. In carrying out the extensive improvement program which was in effect throughout the period 1925-1930, the GCL subsidiaries were not in a position to finance their own improvements except out of earnings and by borrowing from the New Orleans. The New Orleans could have made additional investments in the capital stock of its subsidiaries in order to finance these additions and betterments. Instead, however, the New Orleans continued the system which was in effect when the Missouri Pacific acquired control of the GCL. Earnings of the subsidiaries of the New Orleans were insufficient to meet their obligations for operating expenses, dividends and the cost of the heavy improvement program, with the result that some of these items had to be deferred. Group Exhibit 40 shows that the expenditures for additions and betterments on the GCL during the period 1925-1930 were running from 10.8% to as high as 31.8% of total operat-

ing revenues. (Ex. 301, R. 914-915) A large part of the freight revenues of these subsidiaries was cleared through the New Orleans and, as these items were received by the New Orleans, they were credited against family line bills and other obligations owing by the subsidiaries. However, since the total requirements of the subsidiaries for operating expenses, etc. and for the improvements was in excess of these receipts, some bills had to go unpaid. No matter what particular items remained unpaid, the existence of the unpaid items was fundamentally caused by the improvement program. Thus, the accumulating indebtedness of the GCL subsidiaries in large part represented advances by the New Orleans to its subsidiaries for improvements. Group Exhibits 43 and 44 support this conclusion. (Ex. 305, 307, R. 923, 926) These exhibits are an analysis of the balance sheets of the Brownsville and the Beaumont for the period 1924-1931. The last four lines of these exhibits compare increase in net investments with increase in debt for the period. It will be noted that funded debt remained substantially unchanged during this period, the increase in debt being represented largely by family line bills. As of December 31, 1930, the end of the improvement program, the net increase in investments of the Brownsville was substantially in excess of the cumulative increase in debt. (Ex. 305, R. 923) As of the same date, the increase in debt of the Beaumont was running somewhat ahead of its increase in investment. However, this cannot be attributed to dividends. The Beaumont paid no dividends after the Missouri Pacific acquired control of the GCL. Although the court below and Mr. Thompson gave the Petitioner every opportunity to obtain the information he wanted from the trustee's officers,[1] he put in

[1] The quotation from Mr. Delaney's testimony at page 60 of Petitioner's brief contradicts that witness' previous testimony and the statements of Petitioner's counsel. (R. 495, 433, 472, 527)

evidence only the balance sheets of the Beaumont and the Brownsville. (FF. 44, R. 29) In the absence of the facts which these balance sheets would show, he seeks to prove his case by drawing inferences which are quite inconsistent with the facts reviewed above.

It is plain from the foregoing that until the latter part of 1931 the increase in indebtedness of the GCL subsidiaries to the New Orleans represented an additional investment of the New Orleans in its subsidiaries which was devoted to improvements. Thus, there is no substantial basis for the statement that the age of various items of this indebtedness is an indication that they were not worth their face value. Whatever merit there might be in aging bills due from outsiders, it has no valid application to bills from wholly owned subsidiaries whose condition is fully known to the parent creditor and whose assets could at any time be called upon for payment of the debt.

The fact that the New Orleans acted as banker for its subsidiaries also explains the so-called "paper dividends" of the Brownsville about which Petitioner complains. As already noted, the New Orleans collected a large part of the freight revenues of its subsidiaries. Thus, when the Brownsville declared a dividend, payment was often effected by setting-off the dividend against freight revenues owing to the Brownsville. There can be no doubt that such a set-off accomplished legal payment of the Brownsville dividend.

(2) *1931 Brownsville Dividends.*

On June 17, 1931 the Brownsville declared two dividends aggregating $655,079, vouchers for which went into the family line accounts and were not paid. (Ex. 311, R. 928) On July 11th of the same year another dividend of $3,500,000 was declared by the Brownsville, of which

$1,400,000 was not paid. (Ex. 311, R. 928) The remaining $2,100,000 of the July 11, 1931 dividend was paid in installments over a period of one year and five months following the declaration. (Ex. 311, R. 928) Even if the unpaid $2,055,079 of dividends declared by the Brownsville in 1931 be eliminated, the balance in the earned surplus of the New Orleans at the end of 1931 would still be approximately $300,000 after payment of all dividends declared by the New Orleans. (Ex. 71, R. 432) The court below found that none of the New Orleans dividends were paid out of capital. (FF. 31, R. 23) It is significant that the letter from the Commission's Bureau of Accounts with respect to this matter required the New Orleans to write off only $1,400,000 of the $4,155,079 of dividends declared by the Brownsville in 1931. (Ex. 62, 63, R. 420, 421; R. 928-929, 1034-1035)

(3) *Transactions within the GCL are without Significance.*

Petitioner took up much of the trial in delving into various and sundry transactions between the New Orleans and the GCL subsidiaries. Although two courts have rejected his contentions, Petitioner still insists upon dragging these controversial factual matters into the case. We contend that the transactions within the GCL are without significance. As noted at page 30, *supra*, the New Orleans was the only company in the GCL group which had securities or indebtedness outstanding in the hands of the public. Thus, from the standpoint of a stockholder of the New Orleans, the posture which Petitioner assumes, it is without any consequence whether the assets of the New Orleans consist of family line bills, advances, past due indebtedness or any other obligation owing by its subsidiaries or by shares of stock of the subsidiaries. Nor is it

of any consequence to a New Orleans stockholder whether the dividends declared by the GCL subsidiaries in favor of the New Orleans were advisable or inadvisable. The passing of a dividend[1] or any other payment from one of the GCL subsidiaries to the New Orleans did not change the value of the New Orleans capital stock by one penny. As long as these subsidiary companies were efficiently operated, of which the record affords abundant evidence, a common stockholder of the New Orleans would not be affected by any kind of financial transaction within the group. If Petitioner were a creditor of one of these subsidiaries, the intercompany transactions might be of some importance. As a stockholder of the New Orleans, they are of no concern to him. It is for this reason that we contend that there is no significance whatever to the vast amount of irrelevant matter which Petitioner has injected into these proceedings pertaining to transactions between the New Orleans and its subsidiaries.

(4) *The Consolidated figures.*

For the same reason we contend that the only true picture of the New Orleans and its subsidiaries is given by the consolidated balance sheets (R. 81) and the consolidated income statements. (Ex. 299, R. 912) These consolidated figures eliminate all of the intercompany items and show the actual assets and earnings. Consolidated figures were chiefly used by the Commission in its reports approving the plans of reorganization. Mr. Wyer testified that the board of directors of the New Orleans, recognizing the significance of the consolidated figures, was concerned primarily with them. (R. 912) The board left it to the lawyers and the auditing department to see that dividends from the sub-

[1] During the period 1925-1931 the Brownsville was the only GCL subsidiary of the New Orleans which paid any dividends on its capital stock. (Ex. 199, R. 666)

sidiaries and other intercompany transactions conformed with the requirements of law.[1]

The consolidated income account of the GCL shows that the earnings were ample to cover the dividends declared by the New Orleans. (Ex. 299-301, R. 912, 913, 914) Net income available for dividends from March 1, 1916 to December 31, 1931 amounted to $15,986,390. The dividends declared during this period, including the extraordinary 1924 dividend, amounted to $13,646,191. There is no support for the statement that dividends were paid by the New Orleans out of capital. (FF. 31, R. 23; CL. 14, R. 33)

This leaves for discussion only the question of the propriety of maintaining regular dividends throughout the period 1925-1931. That subject will be dealt with in Point III of the argument.

It seems to us that an impartial examination of the facts of this case will demonstrate beyond any doubt that at the end of 1931 the GCL was a vastly better railroad than it was in 1924 when the Missouri Pacific acquired control, that its service to the public had been greatly improved during the Missouri Pacific regime, and that, in its dealings with the New Orleans, the Missouri Pacific showed a scrupulous regard for the obligations which it had assumed as a majority stockholder of the New Orleans.

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[1] Mr. Frank Andrews, of Houston, Texas, was general solicitor and Mr. Carl de Gersdorff, of New York, was general counsel for the New Orleans during the greater part of the period in question. (Ex. 6-34, R. 403-406, 912, 535)

POINT I

The findings of fact of the District Court will be accepted by this Court unless clear error is shown.

Following a full hearing on the factual issues, the district court made findings. These findings, concurred in by the court below, will be accepted by this Court without re-examination of the evidence, in accordance with the "two-court" rule. *Page* v. *Arkansas Gas Corp.*, 286 U.S. 269, 271 (1932); *Williams Co.* v. *United Shoe Machinery Corp.*, 316 U.S. 364, 367 (1942).

This rule is particularly appropriate in a case such as this. Judge Moore, who presided at the trial in the district court, has supervised the administration of the estates in bankruptcy of the Missouri Pacific, the GCL and their affiliates for a number of years. Over this long period he has acquired an intimate knowledge of the affairs of these debtors, the manner in which their properties were operated and their finances handled. He has also supervised administration of the Frisco and Cotton Belt estates. The knowledge of railroad operating, financing and accounting matters which he has gained in this wide experience specially qualified him to try the issues here involved.

POINT II

The District Court properly held that the pledgees' lien of the RFC and the RCC upon $9,955,226.78 principal sum of the intercompany claim was valid as against any equities in favor of holders and pledgees of the capital stock of the New Orleans. The First and Refunding Bondholders and other lien creditors of the Missouri Pacific have been subrogated to the extent of their interests, respectively, to said pledgees' lien.

We have noted that the Commission authorized the Missouri Pacific to pledge with the RFC, among other col-

lateral, $9,955,226.78 principal sum of the intercompany claim. (p. 22, *supra*) Until sometime after May 29, 1946 the RFC held this collateral to secure loans made to the Missouri Pacific in 1932 and 1933 in the principal sum of $23,134,800. (R. 1129-1137) The pledged portion of the intercompany claim is represented by two negotiable notes. (Ex. Vol. II, 358, 359) The RCC also made loans to the Missouri Pacific in 1932 which were secured by pledged collateral and a second lien on the collateral pledged by the Missouri Pacific with the RFC. (R. 1159) As of May 29, 1946, the RCC loans, with interest, amounted to over $1,900,000. (R. 1160) Until Petitioner filed his Statement of Points on May 13, 1946 (R. 40, 41, 48), there had not been even so much as a suggestion that the RFC and the RCC were not bona fide pledgees for value of $9,955,226.78 of the intercompany claim. Indeed, at the opening of the hearing in the district court, Petitioner's counsel in effect agreed that the RFC was a bona fide pledgee holder of the New Orleans notes and freely conceded that said notes "in the hands of the RFC or its assigns constitute the valid, legal and binding obligations of the New Orleans to the extent required to satisfy the RFC's loans". (R. 382-386, 334; see also R. 176-177, 186-187) This is a concession which had to be made. The rule that the pledge of a negotiable instrument to a bona fide pledgee cuts off all equities of third parties is firmly established in our law.[1] Thus, the pledge by the Missouri Pacific of the two New Orleans notes in negotiable form aggregating $9,955,226.78 in principal sum, as security for the loans made to the Missouri Pacific by

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[1] *New Bern Oil & Fertilizer Co.* v. *Nat. Bank*, 28 F. 2d 554 (C.C.A. 4th, 1928); *Turpin* v. *Dye*, 104 Ind. App. 337, 11 N.E. 2d 70 (1937); *Robb* v. *Cardoza*, 127 Cal. 588, 16 Pac. 2d 325 (1932); *R. F. C.* v. *Thomson*, 186 La. 1, 171 So. 553 (1936). See also Unif. Neg. Inst. L. §§57, 52 and 27 constituting Mo. Rev. Stat. §§3072, 3067 and 3043 (1939).

the RFC and the RCC, operated to cut off any defenses or equities which might have been asserted by or through the New Orleans.

However, Petitioner took the position that the market value of the RFC collateral, exclusive of the intercompany claim, was at the time of the trial in excess of the amount due on the loan. Accordingly, he urged that under rules of marshaling the RFC would be required to satisfy its claim out of its other collateral. (R. 384-386; see also R. 1255) This contention is without merit. For the purpose of allocating new securities in reorganization, market value, and particularly market value at a given date, is of little importance. Value for purposes of reorganization is based upon a number of factors, the most important of which is earning power.[3] For purposes of the 1944 Plan and this review, a valuation of the RFC and the RCC collateral has been made by the Commission. In its Supplemental Report of July 4, 1944 approving the 1944 Plan, the Commission made the following finding:

> "It may be added that certain of the junior creditors also contend that the excess in value, if any, of collateral securing the Finance Corporation, Railroad Credit Corporation and bank loans also fall within the category of free assets. The value of this collateral is discussed hereinafter. The Railroad Credit Corporation has a second lien upon all collateral securing the Finance Corporation loans. Such of the collateral as has a market value is subject to wide fluctuations in price. The record does not warrant a finding of any excess value of the collateral securing

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[3] Section 77(e) (last paragraph); *Ecker* v. *Western Pacific R.R.*, 318 U.S. 448, 483 (1943); *Group of Investors* v. *Milwaukee R.R.*, 318 U.S. 523, 541 (1943); *Old Colony Bondholders et al.* v. *New York, N. H. & H. R. Co.*, 161 F. 2d 413, 419-422 (C.C.A. 2d, 1947) cert. den. 331 U.S. 858 (1947). This also applies to the finding of the district court as to the market value on a particular date of the RFC and the RCC collateral. (R. 1156, 1164, 1177)

> these loans over the amount of the loans". (R. 20761-20762)

Such a finding of value may not be challenged except by showing that the Commission acted arbitrarily or in contravention of law.[1] None of Petitioner's objections pertains to this finding. (R. 227) He offered no evidence at the trial to refute it. Therefore, the above quoted finding of the Commission conclusively determines that the RFC and the RCC needed all of the collateral pledged with them to support the new securities allocated to them under the 1944 Plan. So long as this finding stands, all questions as to marshaling are eliminated.

Accordingly, the district court correctly affirmed the action of the Commission allocating new securities, based on the pledged portion of the intercompany claim, only to the RFC and the RCC. (FF. 23, R. 20; CL. 9 and 10, R. 31-32) Thus, in so far as the pledged portion of the intercompany claim is concerned, Petitioner's Objection 19 was properly overruled.

On May 29, 1946, over four months after entry of the order overruling Petitioner's Objection 19, the district court entered two orders. One authorized Mr. Thompson, as trustee of the Missouri Pacific, to purchase the RFC claim and the collateral securing the same for the sum of $26,033,385.[2] (R. 1155) The other authorized him to purchase the claim of the RCC and the collateral securing the same for the sum of $1,934,507.[2] (R. 1164) These two orders are based on petitions of the trustee for instructions. (R. 1129, 1158) At the hearing on these petitions the First and Refunding and the General Mortgage and

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[1] *Ecker* v. *Western Pac. R.R.*, 318 U.S. 448, 472 (1943); *Group of Investors* v. *Milwaukee R.R.*, 318 U.S. 523 (1943).

[2] Computed by the trustee as of June 30, 1946. (R. 1129, 1158) The exact amounts actually paid in settling with the RFC and RCC do not appear in the record.

the petition of the trustees of the First and Refunding Mortgage for sequestration of income were admitted in evidence without objection.[1] (R. 1190-1191) The chief accounting officer of the Missouri Pacific trustee in bankruptcy testified that substantially all of the surplus funds in the Missouri Pacific estate available for settlement with the RFC and the RCC were derived from property subject to the First and Refunding and General mortgages. (R. 1188)

Petitioner served no answer to either of the above mentioned petitions of the trustee in bankruptcy. He was represented at the May 9, 1946 hearing on these petitions but offered no evidence. (R. 1169) His counsel made a statement at the close of this hearing urging that the RFC and the RCC loans be paid. (R. 1253) It was also urged on Petitioner's behalf that the district court should defer determining the rights of the First and Refunding bondholders with respect to the RFC and RCC collateral and the funds to be used for the paying of their claims. (R. 1254-1257)

The District Court did not undertake to determine the nature and extent of the liens on the funds to be used for purchase of the Missouri Pacific notes held by the RFC and RCC. It did, however, insert provisions in each of the above mentioned orders for the protection of the interests of the lien creditors in these funds. Except for the reference in the quotation below to the RFC, paragraph 2 of each of the orders is the same:

> "That the notes and collateral so acquired from R.F.C. shall be held by Trustee for the benefit of the holders of Missouri Pacific Railroad Company First

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[1] There is outstanding in the hands of the public $223,190,500 principal amount of First and Refunding Mortgage Bonds and $49,339,421 principal amount of General Mortgage Bonds. (R. 20679)

and Refunding Mortgage Bonds outstanding, and for the benefit of any other creditors of said Debtor Company, to the extent of their respective interests, if any, in the cash used in the purchase of said notes and collateral as the same may appear or may be hereafter determined by the Court or any Reorganization Plan, such holders or other creditors being hereby subrogated to the interest, rights, liens, and benefits of the R.F.C. under its said claim and in and to such notes and the collateral pledged as security therefor, to the end that their respective rights and interests may be fully protected in any marshaling of the assets of the Debtor Company or under the terms of any Plan of Reorganization that may be finally confirmed in these proceedings; and the Court hereby expressly reserves jurisdiction to make from time to time such further order or orders as may be deemed necessary or appropriate to protect and enforce the rights and equities of said bondholders and such other creditors in the premises". (R. 1157, 1165)

Petitioner did not appeal from either of these two orders.

The granting clauses of the First and Refunding Mortgage contain a pledge of "tolls, income, rents, revenues, issues and profits" from the mortgaged property. (Ex. Vol. II, 314) Article Eight of the First and Refunding Mortgage grants to the trustees of said mortgage the right to enter upon the mortgaged property, operate it and collect and receive all tolls, earnings, income, rents and profits thereof upon the happening of specified events of default, including a default in the payment of any installment of interest on any of the First and Refunding Bonds which continues for a period of three months. (Ex. Vol. II, 315-322) Similar provisions are contained in the Missouri Pacific General Mortgage. (Ex. Vol. II, 327-333) On June 7, 1933, the trustees of the First and Refunding Mortgage filed a petition in the court below requesting sequestration of income. (Ex. Vol. II, 335-351)

There can be no doubt that the surplus funds derived from the property subject to the liens of these two mortgages are also subject to those liens. In some jurisdictions a bankruptcy trustee or receiver collecting income from mortgaged properties after default acts, from the day of appointment, for mortgage creditors in the order of their pledge priorities regardless of whether they formally demand sequestration.[1] In other jurisdictions it is required that the mortgagee first demand sequestration.[2] The trustees for the First and Refunding Mortgage, no doubt out of abundant caution, complied with the stricter rule. (Ex. Vol. II, 335) Thus, it is clear that the First and Refunding and General Mortgage bondholders had first and second liens, respectively, upon substantially all of the funds used by the trustee in bankruptcy in purchasing the RFC and RCC claims.[3] The other creditors, who may have a minor interest in these funds, are the Central Branch Union Pacific First Mortgage bondholders, the Little Rock, Hot Springs & Western First Mortgage bondholders and the Cairo & Thebes First Mortgage bondholders. (R. 1188)

If it should become necessary, the district court will

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[1] *Mortgage Loan Co.* v. *Livingston*, 45 Fed. 2d 28 (C.C.A. 8th, 1930); *In re Wakey*, 50 Fed. 2d 869 (C.C.A. 7th, 1931); *Associated Co.* v. *Greenhut*, 66 Fed. 2d 428 (C.C.A. 3rd, 1933), cert. den. 290 U.S. 695, 696 (1933); *Brooks* v. *St. Louis-S.F. Ry.*, 153 F. 2nd 312, 317 (C.C.A. 8th, 1946), cert. den. 328 U.S. 868 (1946).

[2] *Freedman's Saving Co.* v. *Shepherd*, 127 U.S. 494 (1888); *In re Brose*, 254 Fed. 664 (C.C.A. 2d, 1918); *In re Hotel St. James Co.*, 65 F. 2d 82 (C.C.A. 9th, 1933).

[3] The order (Ex. Vol. II, 354) entered upon the sequestration petition did not require an impounding of the income from the property subject to the First and Refunding Mortgage. It directed that separate accounts be kept so as to show such income. Thus the lien of that mortgage upon the income may not be a full legal lien, but rather an equitable one, arising from the obligation of the trustee in bankruptcy to account for the funds coming into his hands.

determine the extent of the liens of the First and Refunding and the other mortgage creditors upon the surplus funds. However, we do not believe that a precise determination of these matters will ever be necessary. That would involve a long and wasteful accounting proceeding. The law and the facts just reviewed are sufficiently clear to enable the Commission and the Courts to determine the fairness of any plan for reorganization of the Missouri Pacific System.

As a result of the two above mentioned orders of May 29, 1946, the First and Refunding bondholders and other creditors have been subrogated to the rights of the RFC and the RCC in the Missouri Pacific notes formerly held by them and in the collateral securing said notes. Thereby these creditors as pledgees acquired perfect title to the pledged New Orleans notes.[1] Mr. Thompson, as trustee of the Missouri Pacific, holds these Missouri Pacific notes and the collateral securing them, not as a part of the general assets of the Missouri Pacific estate, but as trustee for the First and Refunding and other lien creditors subject to the terms of the subrogation orders.

Since no appeals were taken from these orders, they have become the law of the case, binding on Petitioner and all other Secured Serial bondholders.

The plan has been returned to the Commission for further proceedings in accordance with Section 77(d). In these proceedings the Commission will no doubt review its finding as to the value of the collateral formerly held by the RFC and the RCC. As noted at page 37, *supra*, the

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[1] Unif. Neg. Inst. L. §58 (1939 Mo. Rev. Stat. §3073). *In re Canal Bank & Trust Co.*, 186 La. 366, 172 So. 421 (1937); *Toll* v. *Monitor Binding & Printing Co.*, 26 Fed. 2d 51 (C.C.A. 8th, 1928); *Burnes* v. *New Mineral Fertilizer Co.*, 218 Mass. 300, 105 N.E. 1074 (1914); *Horan* v. *Mason*, 141 App. Div. 89, 125 N.Y. Supp. 668 (1910).

Missouri Pacific trustee used a total of $27,967,892 in cash which constituted income derived from property subject to the lien of the First and Refunding and certain first lien divisional mortgages, to satisfy the RFC and RCC claims. These lien creditors are now entitled to receive an allocation of new securities as nearly equivalent to $27,967,892 in cash as the collateral formerly held by the RFC and the RCC will justify. If all of that collateral is needed to support such an allocation, there can be no subordination of the pledged portion of the intercompany claim. Only if the Commission finds that the pledged portion of the intercompany claim or some part thereof is not required to support such an allocation will any question concerning such subordination arise. In the present state of the record, Petitioner's case revolves about the $610,000 principal sum of the intercompany claim which was not pledged with the RFC and the RCC.

POINT III

The Courts below properly held that the intercompany claim should not be subordinated.

Petitioner relies upon *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939) and *In re Commonwealth Light & Power Co.*, 141 F. 2d 734 (C.C.A. 7th, 1944), contending that these decisions require that the intercompany claim in its entirety be subordinated to the interests of the holders and pledgees of the capital stock of the New Orleans. His brief selects facts from these cases for special emphasis. These are compared with Petitioner's version of selected facts from the record herein. As a result, his brief omits to state, or lightly passes over, several of the important facts which we think influenced the decisions in the cases upon which he relies. It is, therefore, necessary to supplement Petitioner's statement of these cases.

The Deep Rock Case.

Petitioner's brief omits to mention a transaction between the Deep Rock and its parent, Standard, to which about two and one-half pages of Mr. Justice Roberts' opinion is devoted. (306 U.S. 317-320) This transaction involved acquisition of the "Bradstreet properties" and a cracking plant in the names of dummies. Deep Rock was charged with the advances made by Standard for their acquisition. Subsequently Standard, through another subsidiary, acquired the properties and credited back to Deep Rock the amount of these advances. Standard thereby controlled the Bradstreet properties and cracking plant without which Deep Rock could not function. Deep Rock was then required to lease these properties for a term of years during which they were operated at a heavy loss. Nevertheless, Standard caused Deep Rock to renew the lease, which resulted in further heavy losses. The records

contained inconsistent statements as to who was the real owner of the properties.

The $9,000,000 of open account indebtedness owed by Deep Rock to Standard at the time of bankruptcy included such items as interest compounded monthly, management fees charged by one of the Byllesby affiliates of Standard and rental of properties which Standard had purchased for the account of Deep Rock. The debits amounted to over $52,000,000, against which there were credits in Deep Rock's favor of $43,000,000.

It is not possible to reconstruct the Deep Rock balance sheets from the facts given in the Court's opinion. However, enough is shown to indicate that during most of the period from 1919 to the date of bankruptcy in 1933 publicly held indebtedness and preferred stock of Deep Rock, together with its indebtedness owing to Standard, were so large as to leave no equity for the common stock through which Standard exercised its control over Deep Rock. One of Standard's officials admitted that during most of the period following its organization Deep Rock was "two jumps ahead of the wolf". (306 U.S. at 310)

Petitioner cites the *Deep Rock* record to show that during this period Deep Rock had earnings substantially in excess of its dividends. However, these were earnings shown by the unaudited books of Deep Rock which were under the control of Standard. Mr. Justice Roberts' opinion suggests some skepticism as to the reliability of these books. This doubt seems justified by the fact that the income tax returns of Deep Rock for the same period reported a deficit of $9,000,000. (*Deep Rock Record*, Supreme Court, Vol. III, Ex. 93) In contrast it should be noted that the books of the GCL were required to be kept in accordance with elaborate regulations of the Commission. The Bureau of Accounts of the Commission made frequent and thorough audits of the GCL books. (R. 681-683; FF. 30, R. 23)

There can be no doubt that mismanagement and overreaching permeated the whole relationship between Standard and Deep Rock.

The Commonwealth Case.

In the *Commonwealth* case the parent, Inland, sold an issue of bonds, referred to in the opinion as the Inland bonds, which were secured by the pledge of all the outstanding common stocks of five subsidiary operating companies, including Michigan. The balance sheet of Michigan at organization represented this stock as having a stated value of $1,250,000. (141 F. 2d, at 738) The fact was, however, that if an unjustified initial write-up of $1,966,509 had been eliminated, Michigan's indebtedness would have exceeded the investment in the properties involved to the extent of $162,069. Against this investment of $2,203,845, Michigan had outstanding $2,000,000 of bonds and owed its parent, Inland, $365,914. (*ibid.*, at 737) This initial deficiency in the stated value of the stock wronged the Inland bondholders and was never corrected. Every loan thereafter made to Michigan and every dividend which it declared merely served to aggravate the original wrong done to the Inland bondholders. In contrast to the facts of the *Commonwealth* case, we find that in the instant case the New Orleans, at the time of its acquisition by the Missouri Pacific, was adequately capitalized (R. 266-267) and furthermore that the character and amount of its capitalization was thereafter to a large extent subject to supervision and control of the Commission. Unlike the instant case, the master who tried the facts in the *Commonwealth* case found overreaching and mismanagement.

Analysis of Petitioner's Contentions.

Petitioner's charges as to acquisition of the short lines, the saddling transaction and dividends out of capital have

been dealt with in the preceding statement of facts. He has failed to show that the findings as to these matters were clearly wrong. These are factual questions which require no further consideration.

Before proceeding to the fundamentals, it is necessary to consider Petitioner's argument which proceeds from the premise that borrowing to pay dividends is improper. Contradicting the findings (FF. 18; R. 18) Petitioner asserts that certain of the advances to the New Orleans were for the purpose of financing dividends. Much of Petitioner's argument is based on this contention. The argument only results in confusing the real issues. It substitutes a phrase for thoughtful analysis. There are statements in the *Deep Rock* case which imply that there may be some impropriety in borrowing to pay dividends. In the circumstances of that case borrowing for such a purpose was obviously improper. Certainly it was not the intention of this Court to lay down the rule that borrowing to pay dividends is illegal or improper *per se*. The real objection in the *Deep Rock* case was that funds were borrowed to pay improper dividends. The borrowing was merely one of a number of circumstances which led to the conclusion that the dividends were improper. This interpretation of the language of Mr. Justice Roberts in the *Deep Rock* case is consistent with established rules of corporate law.[1]

In the *Commonwealth* case the court, in describing the conduct of Inland, stated:

> "* * * Also, Michigan, not of its own volition but upon the demand and under the domination of Inland

[1] *Excelsior Water & Mining Co.* v. *Pierce*, 90 Cal. 131; 27 Pac. 44 (1891); *Bankers Trust Co.* v. *R. E. Dietz Co.*, 157 App. Div. 594, 142 N.Y. Supp. 847 (1913); *Alabama Consolidated Coal & Iron Co.* v. *Baltimore Trust Co.*, 197 Fed. 347 (D.C., D. Md. 1912); *Haseltine* v. *Belfast & M. H. L. R. Co.*, 79 Me. 411, 10 Atl. 328 (1887); *Cox* v. *Leahy*, 209 App. Div. 313, 204 N.Y. Supp. 741 (1924).

was required to declare and pay in dividends approximately 80% of its income, at the time when Michigan was engaged on an extensive rehabilitation and expansion program which it was unable to finance out of its own income.* * *" (141 F. 2d, at 738)

Later in the opinion the Michigan dividends are criticized. We do not attempt to justify the Michigan dividends. However, Petitioner seems to construe the *Commonwealth* decision as holding that a corporation borrowing to finance an expansion program may not pay dividends. We disagree with Petitioner's interpretation of the decision. If a rule such as is suggested by Petitioner had been in effect, it would have prevented the construction of a very large part of the productive facilities of the United States. Few corporations today can meet such a test. It would tend to hinder equity financing. The propriety of dividends in such situations depends upon a number of factors. Important among these would be the amount of surplus on hand at the time of declaration, working capital, and past and prospective earnings. If adequate provision is made for amortization of debt, the mere fact that a corporation is borrowing ought not to preclude payment of dividends.

This leaves for consideration the real basis upon which Petitioner must predicate his contention that the intercompany claim should be subordinated. Upon analysis the contention rests upon three grounds: (1) control of the New Orleans by the Missouri Pacific, (2) the alleged inadequate capitalization of the New Orleans, and (3) the alleged improper dividends paid by the New Orleans.

(1) Missouri Pacific control. We freely concede that the element of control exists in the instant case. As the controlling stockholder of the New Orleans, the Missouri

Pacific was a fiduciary. The word "fiduciary" has frequently been loosely used, indicating that its meaning is not always understood. There are various kinds of fiduciaries. The obligations of a controlling stockholder are, for example, not the same as those of a testamentary or express trustee. All fiduciaries have one common attribute. They exercise powers to deal with property or affect rights of those to whom they stand in a fiduciary relationship. Such powers may not be exercised in a manner which will give an advantage to the fiduciary. Thus, the Missouri Pacific, as a majority stockholder, had an obligation to deal fairly with the New Orleans and to do nothing which would improperly prefer it over the holders and pledgees of the securities of the New Orleans.

The Missouri Pacific acquired its controlling interest in the GCL in accordance with an expressed policy of Congress. 49 USCA §5(2); *Control of Gulf Coast Lines by Missouri Pacific R. R.*, 94 ICC 191 (1924). These carriers operate connecting railroads. Thus, it was inherent in the relationship from its inception that there should be a continuing flow of business transactions between them. Such extensive dealings would not be tolerated between a testamentary or express trustee and his *cestui*.

That the Missouri Pacific was a fiduciary does not mean that it was a guarantor of the successful outcome of all transactions in which it and the New Orleans participated. Nor does it mean that the Missouri Pacific was required to subordinate its own interests to those of the New Orleans or that it was expected to exercise superior judgment. The law permits a fiduciary to make honest mistakes. The test of the conduct of the Missouri Pacific as a fiduciary is whether or not it acted in good faith and exercised the judgment which would be expected of an independent management of the New Orleans. This test does not require the Missouri Pacific to be vindicated by subsequent

events or that, in judging its conduct, hindsight is to be substituted for foresight.[1] Application of this test imposes a difficult burden as there is an almost irresistible temptation to allow the transactions under scrutiny to be colored by events which followed.

(2) Capitalization of the New Orleans. The contention that the New Orleans was inadequately capitalized is based primarily on the substantial increase in the New Orleans debt over the period 1924-1932 and the fact that there was no increase in its capital stock during that period. The amount of indebtedness or increase of indebtedness alone is certainly not evidence of inadequate capitalization. The adequacy of the capitalization of a corporate enterprise is tested by whether or not there has been a sufficient investment in the junior stock through which control is exercised, having in mind the risks of the business and the total amount invested in the enterprise. The decisions may be searched in vain for a standard by which to test adequacy of capitalization. No rigid standard has been established. Each case presents a different situation which must be judged upon its own facts.

An examination of the GCL consolidated balance sheet as of August 1, 1931 (R. 81) shows an investment in the common stock of $15,000,000, to which should be added corporate surplus of approximately $8,000,000. This total equity of about $23,000,000 was more than two times the principal sum of the advances about which Petitioner now complains. Clearly the obviously inadequate capitalizations dealt with in the *Deep Rock* and *Commonwealth* cases will not bear comparison with the capitalization of the GCL.

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[1] *Matter of Clark*, 257 N.Y. 132, 140; 177 N.E. 397 (1931); *Crabb* v. *Young*, 92 N.Y. 56, 66 (1883); *Pine* v. *White*, 175 Mass. 585; 56 N.E. 967 (1900); *Taft* v. *Smith*, 186 Mass. 31; 70 N.E. 1031 (1904); *Fairleigh* v. *Fidelity National Bank & Trust Co.*, 335 Mo. 360; 73 S.W. 2d 248, 256 (1934); *Thompson* v. *Hays*, 11 F. 2d 244 (C.C.A. 8th, 1926).

Petitioner criticizes the Missouri Pacific advances to the New Orleans. He suggests that, instead of the advances, the Missouri Pacific should have made contributions to capital of the New Orleans. As previously noted, financing of the improvement program followed an established policy. Initially the improvements were financed by short term borrowings. When these were of sufficient size they were refunded by issuance of long term obligations. This method of financing the improvement program operated successfully until it was halted by the depression. (see p. 20, *supra*) Nothing in these facts suggests that the Missouri Pacific was seeking to prefer itself over others in anticipation of bankruptcy.[1] The record furnishes an example which makes it possible to apply the arm's length test to the policy adopted for the financing of the GCL improvements. We find that the Missouri Pacific adopted the same policy in financing its own improvements. (Ex. 271-277, R. 887-896) This refutes any suggestion that the financing of the GCL improvements was done in bad faith and in disregard of fiduciary obligations. Even if it could be shown that this financing contributed to the ultimate filing under Section 77 by the Missouri Pacific and the New Orleans, it is perfectly apparent that the Missouri Pacific suffered greater injury than the New Orleans. The Commission has found the Missouri Pacific to be insolvent (R. 20801-20813, 20863, 20956), whereas it determined that the New Orleans common stock has value (R. 20955).

There can be no real objection to the short term ad-

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[1] Further substantiation of this is found in the fact that throughout the entire period of Missouri Pacific control it continued to buy in outstanding shares of New Orleans common stock. Between January 15, 1925, approximately the date when the Missouri Pacific assumed control, and the date of bankruptcy the Missouri Pacific holdings of New Orleans common stock increased from 69.38% to 93.15%. As late as 1930, the Missouri Pacific paid $142,905.26 for 1,193 shares of this stock, or an average of about $120 per share. (Ex. 177, R. 630)

vances. It would have been wasteful for the New Orleans to have anticipated the cash requirements of its improvement program by issuing long term bonds several years in advance of the actual expenditures for that purpose. The funds would have remained idle until they could be used, thus building up unnecessary interest charges.

The real question presented by these facts has little to do with the advances. They served only a temporary purpose. Rather the question is whether or not the Missouri Pacific management acted properly in financing the improvement program by the creation of additional debt. In considering this question it is important to note that every dollar of long term debt issued by the New Orleans after 1924 required Commission approval under Section 20a of the Interstate Commerce Act. 49 USCA §20a.

The advances made after the full force of the depression began to be felt were to aid the New Orleans in overcoming deficits. These advances were used to pay such items as interest on funded debt and sinking fund instalments. (FF. 18, R. 18-19) Advances for such purposes were beneficial to the New Orleans and its stockholders. A lenient creditor was substituted for those who would not wait. In such circumstances it is inconceivable that anyone dealing at arm's length with the New Orleans would have supplied the needed funds by subscribing to capital stock of the New Orleans. The propriety of these later advances may be tested by comparing the Missouri Pacific's conduct with what others did under similar circumstances. As late as 1932 and 1933 the RFC and the RCC were making advances to the Missouri Pacific for similar purposes. (R. 110, 1159) In the footnote other instances are cited.[1]

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[1] Loans approved: *Chicago, M., St. P. & Pac. R. R.*, 184 ICC 714 (June 27, 1932); *Chicago & N. W. Ry.*, 180 ICC 533 (Feb. 23, 1932), 193 ICC 370 (Aug. 8, 1933); *Chicago, R. I. & Pac. Ry.*, 184 ICC 597 (June 15, 1932), 189 ICC 522 (Feb. 28, 1933).

There can be no doubt that the advances which now constitute the intercompany claim will meet the test of fairness.

We have heretofore referred to the provisions of Section 20a of the Interstate Commerce Act. That section was designed to give the Commission a large degree of control over the capitalization of railroad corporations. (49 USCA §20a) During the period of Missouri Pacific control, the New Orleans was not permitted to issue, except as provided in §20a(9), any of its first mortgage bonds or other securities without Commission approval.[1] The authorization by the Commission of $7,456,726 of the intercompany claim has already been noted. (pp. 23-24, *supra*) In passing upon the propriety of authorizing the issuance of this note, the Commission was fully advised as to the remainder of the intercompany indebtedness which had been issued under Section 20a(9). *New Orleans, Texas & Mexico Railway Company Notes*, Finance Docket No. 9817, 189 ICC 600 (1933). This action of the Commission is entitled to the greatest weight in passing judgment on the adequacy of the New Orleans capitalization and the propriety of the Missouri Pacific advances. (See R. 1110)

It seems to be perfectly clear that Petitioner has failed to make out any sort of a case on the inadequacy of the New Orleans capitalization.

[1] The suggestion that the proceedings before the Commission resulting in the authorization of securities were *ex parte* and, therefore, entitled to no weight is without merit. The Commission kept itself informed as to the affairs of the GCL through frequent and thorough audits of its books and by detailed reports made by the New Orleans to the Commission's Bureau of Valuation. (FF. 30, R. 23; R. 955-956) At each proceeding for the authorization of funded debt the New Orleans was required to submit a mass of material as to additions and betterments in support of its application. (R. 889-890, 908; see, also R. 1018-1019) In such proceedings the Commission performed a statutory duty. Its decisions in such matters are binding. Moreover, the Commission stated in its report on the 1944 Plan that it was well acquainted with the basis of Petitioner's charges. (R. 20841)

(3) The New Orleans Dividends. In considering the New Orleans dividends it is pertinent to first note that the Secured Serial bondholders were pledgees of New Orleans common stock. The indenture under which their bonds were issued permitted the payment of dividends by the New Orleans. (FF. 7, R. 12) They were advised in the prospectus by which their bonds were offered that dividends at the rate of 7% per annum were being paid. (FF. 7, R. 11) These facts would, of course, not justify improper dividends, but they do show that the Missouri Pacific had a clear right to all dividends which would meet the fairness test. Any dividend of the New Orleans would reduce its assets. That result, however, would not give the Secured Serial bondholders just cause for complaint.

Petitioner seeks to show that there was less justification for the New Orleans dividends than there was for the dividends dealt with in the *Deep Rock* and *Commonwealth* cases. In the *Deep Rock* case there was doubt as to whether reported earnings were not, in reality, a deficit of $9,000,000. This Court described the dividends as having been paid over a long course of years by a company "on the precipice of bankruptcy". In the *Commonwealth* case dividends amounted to 80% of reported earnings. However, because of the deficiency in the stated value of the common stock of Michigan, it was improper to pay any dividends.

The consolidated income account[1] of the GCL from March 1, 1916 to December 31, 1944 is shown on Group

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[1] For the reasons stated at page 32, *supra*, the consolidated earnings of the GCL are important in considering the propriety of the New Orleans dividends. No dividends paid by the New Orleans were based on the undistributed surplus of the GCL subsidiaries. Appendix II of this brief supplements Group Exhibit 38 (Ex. 299, R. 912) by bringing the consolidated earnings of the GCL down to December 31, 1947.

Exhibits 38 and 39. (Ex. 299, 300, R. 912, 913) Consolidated net income of the GCL from March 1, 1916 to the end of 1931 and accumulated net income at December 31 of each of the years during that period are shown on Group Exhibit 40. (Ex. 301, R. 914) This exhibit also shows all dividends declared by the New Orleans from March 1, 1916 to December 31, 1931. There are various methods by which the dividends and income of the GCL may be stated. Petitioner has stated them in a biased manner. The table below shows in condensed form most of the pertinent figures which bear on the dividends.

GULF COAST LINES

Year	Gross Operating Revenue 1	Gross Additions and Betterments 2	Charges to Operating Expenses in Connection with Additions and Betterments 3	Net Income 4	Excess of Cumulative Net Income over Cumulative Dividends at 12/31 5
1924	$15,007,603.	$1,422,667.	—	$2,957,126.	$4,125,[illegible]
1925	15,860,110.	4,070,050.	$343,510.	2,547,633.	5,634,[illegible]
1926	20,104,866.	3,399,986.	592,167.	1,763,278.	6,379,[illegible]
1927	19,082,675.	6,074,361.	715,093.	202,438.-D	5,138,[illegible]
1928	18,664,495.	2,682,837.	379,005.	956,433.	5,057,[illegible]
1929	18,917,440.	3,835,671.	285,601.	845,064.	4,864,067.
1930	18,819,492.	2,020,832.	756,160.	674,950.	4,500,[illegible]
1931	13,435,533.	1,005,199.	234,470.	1,122,422.-D	2,340,[illegible]

D-Deficit

1. Ex. 299, R. 912
2. Ex. 297, R. 910
3. Ex. 303, R. 915
   Average Annual Charges:
   (a) Period of Baldwin Improvement Program (1925-1930).... $511,92[illegible]
   (b) From end of Baldwin Improvement Program to Beginning of War (1931-1939)........ 183,715.
   (c) War Period (1940-1944)........ 334,5[illegible]
4. Ex. 301, R. 914. Annual dividends of the New Orleans 1925-1931 were $1,038,198 (id.).
5. Ex. 301, R. 914. Cumulative from 1916 to the end of the year shown in first column.

It will be noted that in each year during the period 1925-1930 accumulated earnings exceeded all dividends there-

tofore paid by more than $4,500,000. On December 31, 1924, the approximate date when the Missouri Pacific assumed control of the GCL (FF. 6, R. 11), accumulated earnings exceeded dividends by $4,125,087. At December 31, 1930 accumulated earnings exceeded dividends by $4,500,819. In the period 1925-1930 there was only one year in which the GCL sustained a deficit. That was in 1927 when the GCL was seriously affected by floods. It was not likely that such floods would recur for a number of years. (R. 912) In view of the ample surplus of cumulative earnings in 1927, there was no impropriety in continuing the dividend in that year. Also bearing on the propriety of the dividends during the period 1925-1931 was the fact that charges to operating expenses in connection with the heavy improvement program averaged more than $470,000 per year. By way of comparison, during the succeeding nine years these charges dropped to an average of $183,715 per annum. (Ex. 303, R. 915-916) In the light of these facts we think there can be no criticism of the New Orleans directors in declaring regular dividends throughout the period 1925-1930. On facts like these we think this Court will be reluctant to substitute its judgment for that of the management, especially after the lapse of more than seventeen years. The two courts below refused to do so. There can be honest differences of opinion about these facts. They do not, however, suggest any impropriety.

There remains to be considered the year 1931. That was the last year in which dividends were declared on the New Orleans capital stock. The regular 7% dividend was paid in that year, although the GCL sustained a deficit in excess of $1,000,000. (Ex. 301, R. 914) With the benefit of hindsight, it would appear that maintenance of the dividend in 1931 was inadvisable. However, the decision of the board in this regard may not be judged by what happened afterward. In determining whether or not the

New Orleans board acted in good faith, they may be judged only by the facts which were available to them at that time. Several of the members of the board were dead at the time of the hearing and it is impossible to determine all of the considerations they had in mind in continuing the regular dividend throughout 1931.

It is a well known fact that when business conditions are changing from prosperity to depression the change is revealed only gradually. The full results of operations in 1931 were not known until several months after the end of that year. We know that at the end of April 1931 Mr. Safford, the chief operating officer in Houston, was estimating net income of $457,000 for that year. (Ex. 137, R. 601) Mr. Baldwin was taking steps to see that the dividend would be earned. (Ex. 135, R. 601)

It is unlikely that the directors of the New Orleans were aware in 1931 that they were entering a period of one of the deepest depressions in history. There is nothing in the Baldwin-Safford correspondence in April 1931 which indicates that they were aware of the oncoming depression. (Ex. 135, R. 601) The Court will take judicial notice of the fact that businessmen generally were of the opinion in 1931 that the depressed conditions prevailing in the latter part of that year were temporary. *Barlow* v. *Budge*, 127 F. 2d 440, 443 (C.C.A. 8th, 1942), cert. den. 317 U.S. 647 (1942). The President of the United States thought so and requested businessmen to act accordingly. As events turned out, the Missouri Pacific directors and many other businessmen were mistaken in their judgment, but, as already noted, a fiduciary is not a guarantor.

As to the dividends under review, the position of the Missouri Pacific, as a majority stockholder of the New Orleans, was not greatly different from that of a stockholder in any independently managed corporation. Directors of any corporation are elected by stockholders who have a natural

desire for dividends. Conflicting with this desire is another —that the business be preserved on a sound financial basis. These conflicting influences, selfish though they may be, serve to create a balance. Where such influences are allowed free play, the courts have refused to substitute their judgment for that of the elected management.[1] Similar influences were at work in the relationship between the Missouri Pacific and the New Orleans. Missouri Pacific paid a very substantial sum for the common stock of the New Orleans. (Ex. 177, R. 630) The railroads of the Missouri Pacific and the GCL are end to end. The map opposite page 8, *supra*, indicates how the lines of the GCL complement those of the Missouri Pacific. The GCL lines, extending along the Texas and Louisiana gulf coast, serve a large agricultural area and a territory rich in natural resources. As far back as the 1920's, this area was developing rapidly. Group Exhibit 20 illustrates how the citrus and vegetable business was increasing in those years. (Ex. 263, R. 843; see also Group Exhibit 21; Ex. 265, R. 856) It is apparent that the chief interest of the Missouri Pacific was in the interchange of traffic with the GCL.[2] Dividends of $1,000,000 per annum were considerably less important than the Missouri Pacific's own revenues from this traffic. Thus, the Missouri Pacific had its own special reasons for wishing to preserve the GCL on a sound financial basis. To do otherwise would have risked foreclosure of the New Orleans first mortgage and possible sale of the property

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[1] *E. g., Raynolds* v. *Diamond Mills Paper Co.* 69 N.J. Eq. 299, 60 Atl. 941 (1905); *City Bank Farmers Trust Co.* v. *Hewitt Realty Co.* 257 N.Y. 62, 177 N.E. 309 (1931); *Bayer et al* v. *Beran et al* 49 N.Y.S. 2d 2 (Sup. Ct. 1944) (Sheintag, J.).

[2] In 1924 the Missouri Pacific estimated that the revenues from traffic to be delivered to it by the GCL would be not less than $3,000,000 annually. *Control of Gulf Coast Lines by Missouri Pacific R. R.*, 94 ICC 191, 194 (1924). This was just at the beginning of the rapid development of the perishable business from the lower Rio Grande Valley. (Ex. 263, R. 843)

to others. No stockholder of an independently managed corporation could have had greater reasons for desiring financial strength. In these circumstances it is unreasonable to assert that the Missouri Pacific caused the New Orleans dividends to be paid recklessly and in disregard of the effect such dividends would have on its own stockholding in the New Orleans.[1]

Conclusions to Be Drawn from All of the Facts.

The conclusion to be drawn from all of the facts bearing on the relationship of the Missouri Pacific with the GCL is widely at variance with the impression which Petitioner seeks to create. We have noted that the GCL was brought into the Missouri Pacific System as a part of a long-range program to make that system a first class railroad. We have also noted the vast sums which were expended in the improvement program to bring about that result. It is incredible that the men who conceived and carried out this program would wish to mismanage and injure the GCL—one of the vital elements of the system. We have seen that immediately upon acquisition the GCL maintenance expenditures were substantially increased, an extensive improvement program was inaugurated and that active steps were taken to increase GCL

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[1] These conclusions are valid even if Petitioner's borrowing to pay dividends theories be accepted. As we have seen, the plan of the Missouri Pacific was to fund the advances whenever they were of sufficient size to warrant the public sale of bonds. Such bonds would, of course, take priority over the stock interest of the Missouri Pacific in the New Orleans. The funding of advances made to permit improper dividends would thus have been inconsistent with the vital interest of the Missouri Pacific in the New Orleans. But, of course, the Commission would never have permitted the funding of advances for dividends. This demonstrates again the utter futility of the borrowing to pay dividends discussion in Petitioner's brief.

traffic. We have also seen that in its dealings with the GCL in connection with divisions and traffic matters the Missouri Pacific made sure that the GCL was fairly and generously treated. Indeed, if we consider the advantages which the GCL obtained from the special arrangements made with the American Refrigerator Transit Company (pp. 16-17, *supra*) and the savings on the vegetable traffic diverted through Kinder (pp. 15-17, *supra*), these two items alone in dollars and cents will approximately equal all of the dividends received by the Missouri Pacific from the New Orleans in the entire period 1925-1931. These considerations cannot be brushed aside with the assertion that they are not "financial" matters. (Petitioner's brief, p. 24) A railroad can have no finances without traffic, nor can it have profitable traffic without a well-maintained roadbed and an adequate supply of equipment. All are intimately interrelated. This background of facts aids in reaching a conclusion regarding the conduct of the Missouri Pacific with respect to such matters as capitalization, the advances and the dividends. As to each of these, we have seen that the conduct of the Missouri Pacific, though not free from mistakes, will meet the test of fairness. There is abundant evidence to support the findings and conclusions of the courts below that the Missouri Pacific complied with its obligations as a majority stockholder. (FF. 33, R. 24)

Subordination Must Be Commensurate with the Injury.

The Petitioner's brief makes no attempt to deal with the fundamental principles which control the granting of the remedy of subordination. It is an equitable remedy designed to achieve equity. The Petitioner insists upon the complete subordination of the intercompany claim, but he makes no attempt to demonstrate that such a result would be equitable. The reason for full and complete

subordination in the *Deep Rock* case was that mismanagement and overreaching permeated the relationship between Deep Rock and Standard. It was impossible to untangle the many transactions between them so as to permit an approximation of the damage. Standard was responsible for the situation which prevented the making of a fair estimate as to the amount of the injury. As a result, the only available remedy was complete subordination of the parent's claim. This conclusion is confirmed by the opinion in *Pepper* v. *Litton,* 308 U.S. 295 (1939). Speaking of the subordination granted in the *Deep Rock* case, Mr. Justice Douglas wrote:

> "* * * This was based on the equities of the case—the history of spoliation, mismanagement, and faithless stewardship of the affairs of the subsidiary by Standard to the detriment of the public investors. * * *" (308 U.S. at 308)

As we have seen, the record now under review presents no such state of facts as the *Deep Rock* case presented.

Of course, if Petitioner were able to demonstrate that any of the Missouri Pacific loans to the New Orleans had been made in breach of fiduciary duty or that an improper preference had been obtained by making such loan, there would be a basis for subordination or adjustment of the priority of that loan. That, however, would not justify subordination of the entire intercompany claim. Subordination will be made commensurate with the wrong. This principle is clearly stated in an opinion of the court below:

> "* * * since bankruptcy, as we have suggested, is a final liquidation, the power of subordination necessarily must be measuredly and not blankly exercised. It must have a sound regard for the distribution results that will be produced to the creditor whose claim is being subordinated, as well as to the other creditors. It should not operate to take away anything punitively to which one creditor is justly

entitled in view of the liquidation finality, and bestow it upon others, who in the relative situation have no fair right to it. It can therefore ordinarily go no farther than to level off actual inequitable disparities on the bankruptcy terrain for which a creditor is responsible, to the point where they will not create unjust disadvantages in claim positions and liquidation results. And most especially, where there is an attempt to adjust equities between creditors of different legal classes, such as a lienholder and general creditors, must any subordination made of a higher legal right be scrupulously measured and fitted to the actual injury that has been done or the unjust enrichment that is involved." (*In re Kansas City Journal-Post Co.*, 144 F. 2d 791, 800-1 (C.C.A. 8th, 1944))

The Equities in Favor of Missouri Pacific Creditors.

Thus far subordination has been considered without reference to the creditors of the Missouri Pacific. The Commission has found that the Missouri Pacific is insolvent and that there are insufficient assets to satisfy the claims of all its creditors. (R. 20801-20813, 20863, 20956) These creditors are innocent of any of the alleged wrongs done to the New Orleans. The Missouri Pacific management stood in a fiduciary relationship to these creditors also. It would have been a breach of this fiduciary duty in the circumstances existing during the years 1932 and 1933 to have used Missouri Pacific funds as a capital contribution to the New Orleans or to have otherwise wasted Missouri Pacific assets in improper dealings with the New Orleans. The fact is that the New Orleans and its GCL subsidiaries received a dollar or dollar's worth for every one of the advances that constitute the intercompany claim. (Ex. 239, R. 791, 809; Ex. 221-225, R. 701) These are dollars upon which the Missouri Pacific creditors were entitled to rely for the satisfaction of their claims.

We do not assert that insolvency of a parent will in all cases preclude the subordination of its claim against a subsidiary.[1] There may be circumstances in which it would be inequitable to allow such a claim. If a claim against a subsidiary is defective or if its priority was obtained in breach of a fiduciary duty, disallowance or adjustment of priority would seem to be appropriate except where there is a change of position or a situation like that discussed in Point II *supra*. But the Petitioner makes out no such case. The fundamental basis upon which his request for subordination rests is that he and the New Orleans have been injured by various alleged wrongful acts of mismanagement, many of which are not even remotely connected with the intercompany claim. Subordination on such a basis would simply be the setting-off of a claim for damages to the New Orleans against the intercompany claim. Courts of bankruptcy refuse to grant such a set-off.[2] Nor will they presume that the Missouri Pacific

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[1] So far as we are aware, this Court has had no occasion to consider the interests of creditors of an insolvent parent in a case involving subordination. In making this statement we are aware of the argument made in the brief filed on behalf of Standard which is cited in the footnote on page 55 of Petitioner's brief. It is true that proceedings for the reorganization of Standard had been pending under old Section 77B of the Bankruptcy Act. *In re Standard Gas & Electric Co.*, 26 F. Supp. 636 (1939). Prior to the argument of the *Deep Rock* case in this Court the reorganization proceedings involving Standard had been terminated. The plan merely extended maturities and did not eliminate the interest of Standard's stockholders. The district court described the proceedings as "not a genuine reorganization". 26 F. Supp. 636, 641. We do not find that any of the creditors of Standard participated in the *Deep Rock* litigation in this Court. Therefore, this Court had no occasion seriously to consider the interest of Standard's creditors. See also *Consolidated Rock Products* v. *DuBois*, 312 U.S. 510, 524 (1941) and *Prudence Realization Corporation* v. *Geist*, 316 U.S. 89, 97 (1942); *Geist* v. *Prudence Realization Corp.*, 122 F. 2d 503, 508, n.3 (CCA 2d, 1941).

[2] *In re Becker Bros.*, 139 Fed. 366 (D.C. Pa., 1905); *In re Drusilla Carr Land Co.*, 107 F. 2nd 565, 567 (C.C.A. 7th, 1939); *cf. In re American Coils Co.*, 74 F. Supp. 723 (D. N.J., 1947).

estate in bankruptcy is enhanced by assets obtained from the New Orleans, however wrongfully. The fact must be established by tracing.[1] Even a *cestui* may not be preferred over other creditors in the distribution of the bankrupt estate of a defaulting trustee. Subordination may not be used to circumvent the long established rules for the equitable distribution of the assets of a bankrupt.

Aside from these considerations there is a balance of equities in favor of the Missouri Pacific creditors. The Secured Serial bondholders took as collateral for their bonds the most junior security in the New Orleans capitalization. Thereby they accepted the risks inherent in such a security. The real cause of their loss, if any loss there be,[2] was a world-wide economic depression to which the railroads of the west and southwest were particularly sensitive. This was one of the assumed risks. There is abundant evidence in the record to support the findings that the benefits to the New Orleans resulting from its affiliation with the Missouri Pacific far outweigh all of the New Orleans dividends. (FF. 33, R. 24) This is true of the measurable dollars and cents benefits without taking into account intangibles. We have also seen that the New Orleans received a full dollar's worth for each dollar of the advances. These facts weigh heavily in favor of the Missouri Pacific creditors.

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[1] *In re Hallet's Estate*, [1880] 13 Ch. D. 696; *Knauth, Nachod & Kuhne* v. *Latham & Co.*, et al., 242 U.S. 426 (1917); *In re See*, 209 Fed. 172 (C.C.A. 2d, 1913); *In re A. D. Matthew's Sons, Inc.*, 238 Fed. 785 (C.C.A. 2d, 1916), cert. den. 243 U.S. 647 (1917); see Ames, Following Misappropriated Property into its Product, 19 Harvard L. Rev. 511, 520-522 (1906).

[2] At the end of November 1947, prior to the granting of the writ herein, the New Orleans common stock was quoted at 105 bid, 112 asked, and the Secured Serial Bonds were quoted at 106 bid, 108 asked. (Bank and Quotation Record, W. B. Dana & Co., New York, December 6, 1947, pp. 53, 55)

It thus becomes clear that Petitioner's effort to subordinate the intercompany claim is a mere attempt to prefer himself over other innocent creditors of the Missouri Pacific who had no part in the alleged breaches of fiduciary duty. Thus revealed, there is no equity in his plea. It should be rejected.

The courts below properly held that the Secured Serial bondholders are not entitled to have the intercompany claim, or any part thereof, subordinated to the capital stock of the New Orleans. (CL. 12, R. 32)

POINT IV

The District Court properly overruled Objection 19 on the ground of laches.

The district court, after review of the pertinent evidence, overruled Objection 19 on the ground of laches. (FF. 35-43, R. 25-29; CL. 15, R. 33; see also R. IV, 20)

If timely objection is made to the claim of a fiduciary against a debtor in reorganization proceedings, it becomes the duty of the court to carefully scrutinize such a claim before approving a plan. Also, if timely objection is made to such a claim in reorganization proceedings, determination of the validity and rank of such a claim must be made as a prerequisite to the formulation of a plan. These propositions are fundamental and we do not question them.

However, an objection is not timely merely because it is raised prior to approval of a plan under Section 77(e). That is especially true in a case such as this in which the order approves a second plan of reorganization in the proceedings. The doctrine of laches is equitable in nature. It recognizes that injuries and injustices may result from inexcusable delay in asserting rights. A brief review of

the facts will indicate both inexcusable delay in asserting Petitioner's Objection 19 and the serious prejudice which has resulted therefrom.

These proceedings were commenced March 31, 1933 by the filing of the petitions of the Missouri Pacific, the New Orleans and the I-GN under Section 77. (R. 173) The principal debtor filed a plan on October 1, 1935. The Commission held Section 77(d) hearings on that and other plans of reorganization, commencing in February 1936 and continuing intermittently thereafter until September 1937. (R. 175) During these hearings the debtor Missouri Pacific and security holders of the New Orleans placed in evidence detailed information about the GCL, which included much of the material upon which Petitioner now relies. (R. 159-160, 175, 387, 397, 20839-20843) The dates of the Missouri Pacific advances to the New Orleans and the dates and amounts of the New Orleans dividends were put in evidence at these hearings. (R. 83-87, 20839-20841) On January 10, 1940 the Commission's report and order approving the 1940 Plan was promulgated. (R. 20725) In July and October 1940 the court below held hearings on the 1940 Plan. In July 1941 the 1940 Plan was approved. (R. 124) Seven or eight appeals from the approval order were remanded on May 8, 1943 (R. 122) and the 1940 Plan was returned to the Commission. (R. 137) Further hearings were held by the Commission in Brooklyn in October 1943. (R. 141) Up to that time no representative of any Secured Serial bondholder had questioned the validity or propriety of the intercompany claim. (FF. 39, R. 27) The Petitioner appeared at the Brooklyn hearings for the first time in the proceedings. He was represented by counsel. The transcript of these proceedings shows quite plainly that Petitioner did not come to that hearing prepared to present evidence in support of his objection to the intercompany claim. (R. 154-164, 20840) He made

an attempt to cross-examine Mr. Wyer upon some of the matters, later included in his Objection 19, which had no relation to his direct testimony. (R. 157-162) The examiner in charge of the hearing declined to permit such cross-examination. (R. 162, 20841-20842) Petitioner made no attempt to call witnesses of his own for the purpose of introducing evidence bearing on the intercompany claim. (R. 20840)

A few days prior to the commencement of the Brooklyn hearing in October 1943, Petitioner wrote to the trustee demanding that he object to the intercompany claim. (FF. 41, R. 27, 655-658) Petitioner did nothing further until more than a year later when he filed a petition asking leave to object to the Missouri Pacific claim for advances. (R. 247) This petition was denied without prejudice on December 26, 1944. (R. 367) A similar petition had been filed by Petitioner's counsel on behalf of one Foley in July 1944. (R. 166)

As previously noted, the three principal grounds upon which Petitioner seeks subordination of the intercompany claim are (1) Missouri Pacific control of the GCL, (2) inadequacy of the New Orleans capitalization, and (3) the dividends paid by the New Orleans. (p. 47, *supra*) The basic facts with respect to all of these matters have been available to all parties since the inception of the proceedings. (R. 159-161, 20837-20842) Much of Petitioner's evidence was obtained from the GCL reports to the Commission which have been accessible since 1933. (R. 399-489) Mr. Thompson, the trustee in bankruptcy of the Missouri Pacific and the GCL, testified that early in 1934 he retained Messrs. Price, Waterhouse & Co. to make a thorough investigation of the affairs of the GCL. Price, Waterhouse & Co. completed their audit and prior to July 8, 1935 copies of it were filed with the court below and mailed to all parties who appeared in the proceedings, including Mr.

Brandwen who represented Petitioner at the trial below and who at that time represented a dissident committee of First and Refunding Mortgage bondholders. (FF. 25, R. 25, 659-660) This report included consolidated statements and statements for the individual companies. (R. 659-660) The Price, Waterhouse report disclosed the fact that the Missouri Pacific owned over 90% of the New Orleans stock, the details of the GCL capitalization and the fact that the New Orleans had paid regular dividends at the 7% rate throughout the period 1925-1931. It also disclosed the advances, as does the proof of claim filed by the Missouri Pacific in August 1933. (Ex. 1, R. 402) Thus, the basic facts upon which Comstock rests his case have been matters of record from the inception of these proceedings.

Since these proceedings were commenced at least seven representatives of various groups and individuals holding New Orleans securities have appeared before the Commission or the court below. Of these, five represented one or more Secured Serial bondholders or holders of common stock of the New Orleans. (FF. 38, R. 26) Petitioner refers to the petitions filed by the New Orleans First Mortgage trustee and committee. (Petitioner's brief, p. 60) It is significant that these petitions were never pressed.

It is obvious that Petitioner and his predecessors in interest have been guilty of inexcusable delay in presenting Objection 19.

There is ample evidence that the delay in presenting the matters which are the subject of Objection 19 has seriously prejudiced other Missouri Pacific creditors. The district court so found. (FF. 42, R. 28) Petitioner relies heavily on the correspondence between Mr. Baldwin and Mr. Safford, vice president and chief operating officer of the GCL. This correspondence is cited to show that the Missouri Pacific's primary interest in the GCL was in obtaining dividends. (Petitioner's brief, pp. 14-18) Mr. Saf-

ford died in April 1943. (Ex. Vol. II, 361) When we attempted to bring out a conversation between Mr. Kirkpatrick, the chief engineer of the GCL, and Mr. Safford concerning conditions in 1931, Petitioner objected. (R. 832-833) Mr. Safford's first-hand knowledge of the GCL would have been an invaluable aid in explaining the conditions which prevailed in 1931. His views and judgment as to maintenance, new facilities, traffic and prospective revenues and net earnings undoubtedly influenced the decisions of the board of directors of the New Orleans. What information Mr. Safford gave to Mr. Williams or to Mr. Van Sweringen and the extent to which it influenced their judgment are matters which probably would have had an important bearing on the issues here involved.

Mr. F. P. Johnson, who was vice president and chief financial officer of the Missouri Pacific and the GCL for a number of years, died on April 11, 1938. (Ex. Vol. II, 361) Mr. Baldwin relied on Mr. Johnson for information and advice concerning certain aspects of the GCL dividends. Many of the letters in the Baldwin-Safford correspondence show that they were referred by Mr. Baldwin to Mr. Johnson and bear Mr. Johnson's initials. (Ex. 124-132, R. 598, 599, 601) Mr. Johnson was also familiar with the transaction which Petitioner describes as "saddling" the New Orleans with uncollectible debts of the I-GN. (R. 697-699) Mr. Johnson, if he had been alive, would probably have been the most important witness at the trial below. He undoubtedly knew more about the transactions complained of in Objection 19 than any other man in the Missouri Pacific System. Mr. Eckert tried to substitute for Mr. Johnson as a witness. However, Mr. Eckert's memory was faulty. Moreover, Petitioner, in discussing the "saddling" transaction, makes much of the fact that Mr. Eckert testified he had not seen the Missouri Pacific book entries

pertaining to it. (Petitioner's brief, p. 17, R. 702-703) It was Mr. Johnson who determined system accounting policies. Mr. Eckert, who was in the Houston office of the New Orleans during the period in question, could not possibly supply the Missouri Pacific side of the case. Much of Petitioner's case is based on inferences which he draws from entries in the books. Mr. Johnson could have done much to explain these entries.

Mr. Frank Andrews, a member of the New Orleans board until 1929 and its general solicitor, died in December 1936. He was referred to in the testimony on several occasions as having passed on matters which have an important bearing on Objection 19. (R. 535, 605; Ex. 113, 122-124, R. 576, 583, 598; Ex. Vol. II, 362)

Mr. O. P. Van Sweringen, chairman of the boards of the Missouri Pacific and the New Orleans in 1930 and following, died in 1936. Petitioner's brief demonstrates how important his testimony would have been. (Ex. Vol. II, 360)

Mr. E. J. White, vice president and general solicitor of the Missouri Pacific, was familiar with many of the matters involved in Petitioner's Objection 19. He died on December 29, 1935. (Ex. Vol. II, 362)

Other witnesses mentioned by Mr. Railey certainly would have been called if they had been alive, and, as Mr. Railey indicated, their testimony would have been helpful to the district court in determining the issues presented by Petitioner's Objection 19. (Ex. Vol. II, 362, R. 191-207)

The Petitioner has heretofore suggested several persons who might have been called as substitutes for those who are now dead. Mr. Baldwin was called by Petitioner. It will be pointed out that Respondents did not interrogate him. His testimony clearly indicated that he was interested primarily in building a railroad and operating it. (R. 596-

608) He relied on Mr. Williams and Mr. Van Sweringen and the board of directors to supply him with the needed funds. Moreover, the trial was held in January and March 1944. It was not our wish to ask Mr. Baldwin to divert his attention from his important war job. It seems obvious that there could have been no substitutes for the deceased witnesses mentioned above. In any event the Petitioner is entitled to no presumption in his favor in this matter. The situation exists because of Petitioner's inexcusable delay.

Not all of the documentary evidence was available. Under regulations of the Commission various documents may be destroyed after the lapse of specified periods of time. Such destroyed documents contained evidence supporting the book entries. (R. 193-194, 196-197, Ex. Vol. II, 362) Petitioner does not accept the book entries at face value. He seeks to show that some of them were false.

Petitioner is in a court of equity asking for subordination, an equitable remedy. The doctrine of laches is also designed to achieve equity. A court of equity frowns upon a stale demand and, if it be coupled with change of position on the part of third parties or serious prejudice to those who must defend against such a demand, the court will leave the parties where it finds them.[1]

The doctrine of laches is applied in courts of bankruptcy.[2]

Laches may operate as a bar to the making of objections to a claim filed in bankruptcy.[3]

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[1] *Graham* v. *Boston, Hartford & Erie R. R. Co.*, 118 U. S. 161 (1886); *Moran* v. *Horsky*, 178 U. S. 205 (1900); *Barnhart* v. *Western Maryland Ry. Co.*, 128 F. 2d 709 (C.C.A. 4th, 1942), cert. den. 317 U. S. 671 (1942); *Penn Mutual Life Insurance Co.* v. *Austin*, 168 U. S. 685 (1898).

[2] *In re Trustees System Discount Co.* of Chicago, 85 F. 2d 467 (C. C. A. 7th, 1936), cert. den. 299 U. S. 599 (1936).

[3] *In re American S.S. Nav. Co.*, 14 F. Supp. 106 (D. C., E. D. Pa., 1933), aff'd *sub nom. Cooper* v. *Rauch*, 82 F. 2d 1005 (C. C. A. 3rd, 1936); *In re Nichols*, 166 Fed. 603 (D. C., N. D. N. Y., 1909).

Some of the transactions now questioned occurred over twenty-two years ago. None of them is less than fifteen years old. Petitioner's case is largely based on old records and the testimony of witnesses whose memories are dimmed by the passage of time. (R. 548, 551, 552, 576, 589, 598) It seems obvious that the proponents of the Plan were seriously prejudiced by the long and inexcusable delay in presenting Objection 19.

The following comments of the Circuit Court of Appeals for the Fourth Circuit made in 1942 aptly apply to the facts just reviewed:

> "We do not wish to be understood as holding that the mere lapse of 19 years prior to the bringing of this action is sufficient, in itself, to deny relief on the ground of laches. Our point is that, after having carefully considered the background and history of this case in all of its peculiar aspects, we feel the interests of justice would best be served by our holding that the action is barred by unreasonable delay. The many difficulties of the appellee railroad inherent in the delayed defense of this action at this turbulent period in our national existence more than outweigh the alleged equity of restitution to appellants for the alleged nefarious acts committed by appellee two decades ago. This is in accord with the firmly imbedded principle that equity will not aid a plaintiff whose unexcused delay, if the action were allowed, would be unduly prejudicial to the defendant." *Barnhart* v. *Western Maryland Ry. Co.*, 128 F. 2d 709, 715 (C. C. A. 4th, 1942); cert. den. 317 U. S. 671 (1942).

It would be difficult to imagine a state of facts that would present a stronger appeal to a court of equity for the application of the doctrine of laches than is presented here. We conclude, therefore, that Petitioner's objection was properly overruled on the ground of laches. (CL. 15, R. 33; R. IV, 20)

POINT V

The courts below properly held that the trustee in Bankruptcy of the Missouri Pacific and the Gulf Coast Lines has discharged his duty with fidelity and in conformity with the Bankruptcy Act.

Petitioner's Point IV seems to suggest that another three years should be spent delving into dusty records and trying again the issues of this case. It is apparently of no consequence to him that this would involve delay of the reorganization for several more years. No plan for these debtors can be formulated as long as there is any uncertainty concerning the intercompany claim. Although we held different views at one time (R. 722), we now believe it to be practically impossible to devise a plan with alternative allocations which would anticipate all of the possible ways in which the issues presented by this record can be disposed of.

The statements in the Petitioner's brief concerning Mr. Thompson are most unfair. These statements leave the impression that Mr. Thompson has been indifferent to the affairs of the New Orleans and that no investigation was made. The statements in their entirety misrepresent Mr. Thompson's position.

In 1934 Mr. Thompson with the acquiescence of his then co-trustee, Mr. L. W. Baldwin, retained Messrs. Price, Waterhouse & Co. to audit the books of the Missouri Pacific and the GCL. From time to time as the audit progressed he conferred with the auditors. He was advised by Price, Waterhouse & Co. after they had completed their investigation of the GCL that they found nothing questionable concerning the intercompany claim. (R. 646-648) Petitioner has heretofore taken the position that the investigation of the GCL was not a matter for auditors. However, he contends that the only matters relative to the

issues presented by Objection 19 are financial. (Petitioner's brief, pp. 24, 50) The great bulk of Petitioner's case at the trial below was the testimony and exhibits of two auditors, Mr. Delaney, a certified public accountant retained by Petitioner (R. 398-496), and Mr. Eckert, formerly the auditor of the GCL and at the time he testified the chief accounting officer of the System. (R. 496-570, 629-637, 660-711)

Mr. Thompson had retained special counsel, Judge Fred L. Williams, to review the Price, Waterhouse reports and to advise the trustee as to whether anything disclosed in the audit should be investigated further. (R. 648) In July 1935 Mr. Thompson called a conference of the interested parties. It was attended by counsel for various mortgage trustees and protective committees, including Mr. Brandwen who at that time represented a First and Refunding committee and who was Petitioner's attorney at the trial below. (R. 648-653) At this conference the work of investigation which Judge Williams had conducted was reviewed. At the conclusion of the conference Mr. Thompson requested any suggestions which counsel might have concerning other matters that ought to be investigated. No suggestions having any bearing on the matters complained of in Objection 19 were ever received by Mr. Thompson in response to this request. (R. 653)

Subsequently an order was entered authorizing examinations under Section 21a of the Bankruptcy Act, an order which Mr. Brandwen had frequently requested Mr. Thompson to obtain. No one made any suggestion that the 21a examination should be directed toward the intercompany claim. (R. 653) In 1936 Mr. Thompson filed a motion in which he reported that he had found no irregularities of the kind now complained of by Petitioner. (R. 654) Nevertheless, he suggested that the Commission be asked for information which it might have requiring further investi-

gation. The order entered upon this motion requested the Commission's suggestions. (R. 654-655) The Commission's reply contained no suggestions. (FF. 37, R. 26) Petitioner's brief does not mention the investigation by Judge Williams or the trustee's report to the court concerning irregularities. To us it is significant that after this careful investigation the trustee's report contained nothing that would give support to the subordination claims contained in Objection 19. It also refutes the statement that Mr. Thompson first announced his position at the trial below. (Petitioner's brief, p. 61)

Petitioner refers to the petitions filed in 1937 by the New Orleans first mortgage committee and the trustee of that mortgage. (R. 87, 101) These petitions show that Mr. Thompson, after investigating various matters complained of therein, made certain adjustments but refused to make others which those petitioners demanded. Yet Petitioner creates the impression that Mr. Thompson did nothing.

In addition to all this, the Commission had received voluminous evidence pertaining to the GCL, the advances and the dividends at its hearings on the first Plan of Reorganization. (R. 83, 159, 160, 208-209, 211, 20839-20843) The representatives of the New Orleans security holders had retained competent experts (R. 208-209) and were represented by able counsel at those hearings.

The record is in complete contradiction to the statements and suggestions in the Petitioner's brief that there has been an inadequate investigation of the affairs of the GCL. It is perfectly plain that Mr. Thompson's conduct in these proceedings has conformed with the highest standards of a fiduciary. Two courts, after having examined the merits of Objection 19, have said so. (FF. 45, R. 29; CL. 17, R. 33; R. IV, 27)

None of the decisions upon which Petitioner relies in Point IV of his brief is in point. (Petitioner's brief, pp. 58-59) They deal with a situation quite different from a trusteeship under Section 77. It has been the practice in proceedings under Section 77 to appoint a common trustee or trustees for all of the debtors within a single system. This practice is contemplated by the provisions of Section 77(a) which authorizes subsidiaries to file petitions in proceedings involving the parent. This practice is in the public interest. It facilitates the continued operation of a railroad system as an integrated unit. To have separate trustees for the New Orleans and Missouri Pacific, each competing with the other as to traffic and other matters, could result in serious consequences. Its effect on both public and private rights cannot be estimated. Certainly no such far-reaching decision ought to be made on the basis of the record now under review. An effort similar to Petitioner's was made in the *Rock Island* reorganization. There the same trustees were appointed for each of the debtors in the Rock Island system. These trustees declined to affirm a lease of property of one of the subsidiaries (Rock Island, Arkansas and Louisiana Railway Co., referred to as "Rial") to the parent and refused to pay rents under the lease. Bondholders of the subsidiary asked the court to remove the trustees on the ground of conflicting interests. In affirming the order denying the motion to remove, the Circuit Court of Appeals for the Seventh Circuit stated:

> "It is further contended by appellants that there is such a conflict of interest here presented as to preclude the trustees of the principal debtor from fairly representing Rial, and that the District Court should have removed them and should have appointed another trustee or trustees for Rial. It is quite true that a case of this character always involves many conflicting interests. Similar conditions nearly al-

ways arise in equity receiverships. But that fact alone has seldom, if ever, been used as a reason for appointing more than one set of trustees. If appellants' contention in this respect were permitted with respect to all of the subsidiaries, it would be most difficult indeed to make any progress whatever in accomplishing the thing which Congress obviously intended." *In re Chicago, R. I. & P. Ry. Co.*, 110 F. 2d 395, 401. (C. C. A. 7th, 1940)

If a court is capable of dealing impartially with the affairs of several debtors, there appears to be no reason why the court's officer, a trustee in bankruptcy, who has no personal interest in any of their affairs, is not also capable of acting with complete impartiality. The record is convincing proof that Mr. Thompson has done so in this case. The courts below so determined. (FF. 45, R. 29; CL. 17, R. 33; R. IV, 27)

POINT VI

The decision below should be sustained on the ground that the order of the District Court approving the 1940 Plan was final and conclusive as to the validity and priority of the intercompany claim.

In Point IV *supra* we reviewed the history of these proceedings. There it was noted that in the Section 77(d) and (e) proceedings before the Commission and the district court, which resulted in approval of the 1940 Plan by the district court, there was not so much as a suggestion that anything was wrong with the intercompany claim. (R. 20839-20840) The Commission's report on the 1940 Plan indicated clearly that the allocations of new securities to the Secured Serial bondholders and the New Orleans Common stockholders were based on the conclusion that

the intercompany claim was valid and ranked in priority to the New Orleans Common Stock.[1]

All interested parties were duly notified of and given an opportunity to participate in the proceedings which resulted in approval of the 1940 Plan by the district court. In these circumstances the district court's order of approval was final and conclusive as to all issues of law and fact which could have been, but were not, raised in those proceedings.[2] The petitioner and other Secured Serial bondholders having failed to urge invalidity or subordination of the intercompany claim and to present supporting proof were, as to such matters, bound by the district court's order approving the 1940 Plan.

It is immaterial that appeals from the approval order were remanded without passing on the merits of the appeals and that the district court, as permitted by Section 77(e),[3] returned the 1940 Plan to the Commission for further proceedings in accordance with Section 77(d). (R. 122) The opinion and order of the district court returning the proceedings to the Commission clearly indicate that the 1940 Plan failed of confirmation because of changed con-

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[1] Missouri Pacific R. R. Reorganization, 239 ICC 7, 129-130 (1940).

[2] *Grubb* v. *Public Utilities Commission*, 281 U. S. 470, 478-479 (1930); *Chicot County Dist.* v. *Bank*, 308 U. S. 371 (1940); *Stoll* v. *Gottlieb*, 305 U. S. 165 (1938).

[3] Section 77(e) provides in part:

> "* * * If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder."

ditions and the lack of certain findings not related to th intercompany claim. (R. 124-139) It was not the purpos of Section 77, in permitting plans of reorganization to b returned to the Commission for further proceedings, t afford parties a second opportunity to try issues whic through lack of diligence they failed to present to th Commission at the prior hearings on the plan. The Petitioner suggests no reason why he or his predecessors i interest did not present their objections to the intercompany claim and supporting proof prior to the time whe the district court approved the 1940 Plan. They had seve years in which to do so—1933-1940. The basic facts wer all available prior to the date of the approval order an most of them were a matter of public record. (See pp 65-67, *supra*) Thus, in the further proceedings on the pla the Petitioner had no right to present evidence or be hear on any issue pertaining to the validity or priority of th intercompany claim. That issue had been disposed of b the order approving the 1940 Plan. The Commission undoubtedly had these considerations in mind when it state in its report approving the 1944 Plan:

> "* * * Although more than 12 years hav elapsed since the Missouri Pacific made its advance of cash to the New Orleans, as above stated, th invalidity of any part of these advances has neve been established and we will assume for the purposes of this proceeding that they are valid obligations of the New Orleans in determining the righ of, and extent to which, holders of Missouri Pacifi 5¼-percent bonds and the New Orleans stockholder should participate in the plan of reorganization." (R. 20842, see also R. 20837-20842, 154, 161)

These conclusions are not founded upon mere technicalities. They are supported by the necessity for an orderl and expeditious procedure in the disposition of railroa

reorganizations. There is an important public interest in these reorganizations. One of the chief reasons for the enactment of Section 77 was to do away with the delays of the equity receivership procedure. This Court has stated that the parties are bound to exercise the highest degree of diligence in expediting the reorganization proceedings and that it is the duty of the courts and the Commission to see that they do.[1]

Section 57k of the Bankruptcy Act[2] is inapplicable to the situation presented by this record. That section will not be applied if to do so would thwart one of the underlying purposes of Section 77, namely, the reorganization of carriers as expeditiously as is consistent with giving all interested parties an adequate opportunity to be heard.[3]

Unless the courts insist on some reasonable adherence to an orderly and expeditious procedure, one of the important purposes sought to be achieved by the enactment of Section 77 will have failed.

The conduct of Petitioner in these proceedings is a striking example of the effect of dilatory conduct. Petitioner's first statement of his objections to the intercompany claim was made at the Commission's second hearings in October 1943. As already noted, he did not come pre-

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[1] *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I. & Pac. Ry. Co.*, 294 U. S. 648, 685 (1935). See also *Group, etc.* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U.S. 523, 545 (1943).

[2] "§57k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed." 11 USCA §93k.

[3] "§77(1). In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

pared to present substantial proof in support of his objections. (R. 141-165) The subsequent attempts to obtain a hearing on the intercompany claim in the district court after approval of a revised plan by the Commission, if successful, would have delayed the proceedings further. (R. 166, 247) At the hearings in the district court on the plan in January and March 1944, most of the time was occupied with Petitioner's Objection 19. The voluminous and complicated record made at that hearing undoubtedly explains to a large extent the reason why the district court required almost a year to decide the issues. It was not until January 22, 1945 that the orders approving the plan and overruling Objection 19 were entered. By the time Petitioner's four appeals had been decided by the court below—almost four years after close of the Commission's second hearings—the 1944 Plan was obsolete. Accordingly, at the suggestion of the Commission the court below remanded the proceedings for the preparation of a third plan of reorganization. (See p. 3, *supra*) Even now the pendency of this cause will probably require the Commission to delay its approval of the third plan of reorganization until this Court finally determines the issues.

This is not all. At the Commission's second hearings in October 1943, Petitioner for the first time raised another issue involving subordination. (R. 154; see also his Objections 20-23, inclusive R. 233) At the hearings on the 1944 Plan the district court ordered these issues segregated for separate trial. (R. 736-737, 776) To date the Petitioner has not brought these issues on for trial. Unless this Court clearly indicates its disapproval of such dilatory conduct, Petitioner may be expected to urge the same or some other objections in the further proceedings before the Commission which are now scheduled to commence on March 23, 1948. If the pattern of the instant case be followed, the issues thus raised are likely to be presented to

this Court for determination four years hence. Meanwhile holders of millions of dollars of securities of the Missouri Pacific System may be required to stand by, deprived of the income on their new securities and the benefits of a management unhampered by the burdensome restrictions that the bankruptcy proceedings of necessity impose.

Certainly it was not the intention of Congress that the federal bankruptcy courts should be used as a means of hindering and delaying creditors in any such manner as is disclosed by the record under review. Petitioner's conduct in these proceedings has been in complete disregard of the interest of the public which this great railroad system serves and of creditors of the system who throughout the 77 proceedings have been stayed from enforcing their legal rights. The instant case affords this Court a most suitable opportunity to restrain parties whose dilatory conduct has contributed substantially to the extension of these proceedings over a period of almost fifteen years and to put real meaning into the words of the *Rock Island* and *Milwaukee* decisions.

No injustice will be done to the Petitioner in denying the relief which he requests. He and all other Secured Serial bondholders were given a full opportunity to present their objections to the intercompany claim. Fairness and justice do not require more than this.

CONCLUSION.

The Petition should be dismissed or the order of the Court below should be affirmed.

Respectfully submitted,

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Dated: February 28, 1948.

APPENDIX I

Excerpts from Section 77

(d) . . . After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court.

(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice,

detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders . . .

. . . If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necesary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis

which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts. . . .

APPENDIX II

GULF COAST LINES

CONDENSED INCOME ACCOUNT
1944 - 1947

	1944	1945	1946	1947
Railway Operating Revenues	$47,752,223	$41,299,895	$36,908,802	$40,357,49[illegible]
Railway Operating Expenses:				
Maintenance of Way and Structures	$ 7,562,741	$ 7,464,953	$ 6,782,237	$ 7,387,44[illegible]
Maintenance of Equipment	4,380,404	6,022,240	4,322,004	4,778,20[illegible]
Traffic	663,450	693,086	799,464	846,81[illegible]
Transportation	11,351,989	11,203,429	12,324,792	13,458,32[illegible]
Miscellaneous Operations	181,783	151,437	112,154	110,64[illegible]
General	903,658	907,751	1,077,236	1,230,5[illegible]
Total Railway Operating Expense	$25,044,025	$26,442,896	$25,417,887	$27,811,9[illegible]
Net Revenue from Railway Operations	$22,708,198	$14,856,999	$11,490,915	$12,545,5[illegible]
Railway Tax Accruals	12,598,920	7,575,147	2,477,989	2,999,31[illegible]
Railway Operating Income	$10,109,278	$ 7,281,852	$ 9,012,926	$ 9,546,18[illegible]
Rent Income	551,459	590,667	545,187	398,10[illegible]
Rents Payable	4,069,149	3,851,420	3,601,326	3,648,57[illegible]
Net Railway Operating Income	$ 6,591,588	$ 4,021,099	$ 5,956,787	$ 6,295,37[illegible]
Non-Operating Income:				
Dividend Income	$ 3	$	$	$ 80[illegible]
Income from Funded Securities	3,015	2,315	5,950	3,55[illegible]
Income from Unfunded Securities and Accounts	188,306	200,117	222,644	110,81[illegible]
Other	116,420	Dr. 6,895	94,100	184,02[illegible]
Total	$ 307,744	$ 195,537	$ 322,694	$ 299,27[illegible]
Miscellaneous Deductions from Income	54,099	122,212	70,241	72,16[illegible]
Income Available for Fixed Charges	$ 6,845,233	$ 4,094,424	$ 6,209,240	$ 6,522,48[illegible]
Fixed Charges:				
Rent for Leased Road and Equipment	$ 2,974	$ 1,212	$ 2,605	$ 1,49[illegible]
Interest on Funded Debt*	2,783,698	2,780,938	2,780,938	2,780,92[illegible]
Interest on Unfunded Debt	4,312	85,700	25,902	10,53[illegible]
Total Fixed Charges	$ 2,790,984	$ 2,867,850	$ 2,809,445	$ 2,792,94[illegible]
Net Income	$ 4,054,249	$ 1,226,574	$ 3,399,795	$ 3,729,53[illegible]

Source: Company Records—Office of Chief Acctg. and Financial Officer, St. Louis, Mo. January 29, 1948.

* Includes $117,705 annual fixed interest on $2,354,100 principal amount of First Mortgage 5% Income Bonds due 1935, which were retired on December 1, 1947. (D.C. Rec. 2557[illegible]) This footnote added by Respondents.